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Montana's Property Tax and the 4-R Act and Other Revenue Oversight Issues

A Report to the 49th Legislature

Report and Recommendations of the Revenue Oversight Committee

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MONTANA'S PROPERTY TAX AND THE 4-R ACT AND OTHER REVENUE OVERSIGHT ISSUES

A REPORT TO THE 49TH LEGISLATURE

REVENUE OVERSIGHT COMMITTEE

DECEMBER 1984

Published by

MONTANA LEGISLATIVE COUNCIL
Room 138
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Helena, Montana 59620

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TABLE OF CONTENTS

Page

Summary of Recommendations i

Executive Summary ii

House Joint Resolution 31 v

Senate Joint Resolution 23. vi

CHAPTER ONE - Historical Development of Property Taxation: From Europe to Montana 1-1

CHAPTER TWO - Federal Constraints on State Taxation of Railroad Property 2-1

CHAPTER THREE - Classification, Litigation, and Legislative Responses to the 4-R Act 3-1

CHAPTER FOUR - Railroad and Utility Valuation and Options for Complying with Federal Legislation . . 4-1

CHAPTER FIVE - Senate Joint Resolution 23 5-1

CHAPTER SIX - Miscellaneous Committee Activities. . . . 6-1

Recommended Legislation:

LC 420. 4-30
LC 58. 5-33
LC 2. 6-15
LC 18. 6-19
LC 112. 6-21
LC 98. 6-25

SUMMARY OF RECOMMENDATIONS

The Revenue Oversight Committee recommends that the 1985 Montana Legislature enact the following legislation:

1. LC 2 - "AN ACT PROVIDING FOR ESTABLISHMENT OF AGRICULTURAL LAND VALUES FOR THE REVALUATION CYCLE BEGINNING JANUARY 1, 1986; AMENDING SECTION 15-7-210, MCA; AND PROVIDING A DELAYED EFFECTIVE DATE."

2. LC 18 - "AN ACT REMOVING THE STATE TAX APPEAL BOARD FROM THE APPEAL PROCESS RELATIVE TO BEER AND LIQUOR LICENSING; AND REQUIRING APPEALS TO BE CONDUCTED PURSUANT TO THE MONTANA ADMINISTRATIVE PROCEDURE ACT."

3. LC 58 - "AN ACT EXEMPTING CHURCH-OWNED PASSENGER VEHICLES FROM TAXATION AND LICENSE FEES; AMENDING SECTIONS 15-6-201 AND 61-3-532, MCA."

4. LC 98 - "AN ACT PERMITTING LOCAL GOVERNING BODIES TO GRANT TAX BENEFITS FOR THE RECONSTRUCTION OR EXPANSION OF EXISTING BUILDINGS OR STRUCTURES; AMENDING SECTION 15-24-1501, MCA."

5. LC 112 - "AN ACT PROVIDING INCREASED FLEXIBILITY IN TRANSFERRING ALL-BEVERAGES LICENSES BY REVISING TRANSFER QUOTA LIMITATIONS; ELIMINATING THE 5-YEAR RESTRICTION ON MORTGAGING OR PLEDGING SUCH A LICENSE AS SECURITY; ELIMINATING THE PROHIBITION OF TRANSFERRING A PREVIOUSLY TRANSFERRED LICENSE; REDUCING THE ANNUAL FEE FOR A CATERING LICENSE; REVISING THE PROCEDURE FOR A CATERING ENDORSEMENT; AND REDUCING THE FEE FOR CATERING AN EVENT; AMENDING SECTION 16-4-204, MCA."

6. LC 420 - "AN ACT TO GENERALLY REVISE MONTANA PROPERTY TAX CLASSIFICATION LAW TO COMPLY WITH FEDERAL LAW GRANTING CERTAIN TYPES OF PROPERTY SPECIAL CONSIDERATION: REQUIRING THE DEPARTMENT OF REVENUE TO ANNUALLY REVALUE ALL COMMERCIAL AND INDUSTRICAL PROPERTY: REQUIRING THE DEPARTMENT OF REVENUE TO CONDUCT AUDITS OF ASSESSMENTS ON COMMERCIAL AND INDUSTRIAL PROPERTY: AMENDING SECTIONS 15-6-101, 15-6-134, 15-5-135, 15-6-137 through 15-6-142, 15-6-151, 15-7-111, 15-7-202, 15-7-307, 15-8-104, 15-8-111, 15-16-611, AND 15-23-202, MCA; AND PROVIDING EFFECTIVE DATES."

EXECUTIVE SUMMARY

Overview of Interim Activities

The activities of the Revenue Oversight Committee covered a broad range of topics during the 1983-1985 interim, due partially to responsibilities assigned to the Committee by the 48th Legislature and partially to projects taken on by the Committee itself.

The Revenue Oversight Committee has as one of its responsibilities the task of reviewing the administrative activities of the Department of Revenue. This task covers all manner of issues and interest areas, including the oversight and review of: the proposal of new administrative rules by the Department; amendment or repeal of existing rules; reappraisal of taxable property; the administration of the property tax and income and corporation license taxes; a variety of liquor issues, including licensing and liquor taxes and profits; mineral taxation; audits; litigation; and the relationship of the Department of Revenue and local officials and employees.

A great deal of the Committee's work centered around these statutory responsibilities, most of which were viewed as a matter of routine. But another part of the Committee's work stemmed from interim studies assigned to the Committee by the 48th Legislature. Among those studies were an in-depth examination of Montana's property tax classification system (House Joint Resolution 31), and an examination of tax deductions, exclusions, exemptions, and credits (Senate Joint Resolution 23).

The latter of the studies mentioned above did not fully develop during the interim because of several factors.

Chief among those factors were the Committee's interest in and the relative importance of the other interim study, and a substantial lack of hard data on deductions, exclusions, exemptions, and credits.

The other study, House Joint Resolution 31, occupied a considerable amount of the Committee's time and attention. It began as an examination of Montana's property tax classification system taken in context with property tax systems in other states and countries. It then became focused on the taxation of railroad property and other types of property granted federal protection. The study was refocused finally on the State's property tax system, but with emphasis on revisions to the system that would ensure a stable tax base without substantial shifts in tax burden, and at the same time would result in compliance with federal law. This study was undertaken with a great deal of interest and sincerity by the Committee, which in the final analysis had to make some very difficult decisions on tax policy with statewide implications.

Organization of Final Report

The organization of this final report of the Revenue Oversight Committee centers around the Committee's activities during the interim. Because the Committee concentrated so heavily on the property tax system and the taxation of railroads' property, the bulk of the report -- Chapter One through Chapter Four -- is given to the railroad and property taxation issues outlined in House Joint Resolution 31.

Chapter Five of the report is a brief explanation of the Committee's activities regarding the second study, Senate Joint Resolution 23. The report concludes in Chapter Six with an outline of the Committee's other activities -- simply a pot pourri of discussions and recommendations.

Each chapter is written as a separate document, including recommendations, appendices, and suggested legislation. This format results in some repetition of material, e.g., selected provisions of the 4-R Act, but also provides a complete reference document. Consequently, Committee recommendations are included at the end of the appropriate chapter and bill drafts in the appendices to the chapter. Therefore, a perusal of the Table of Contents will prove to be a time-saving effort.

HOUSE JOINT RESOLUTION NO. 31

A JOINT RESOLUTION OF THE SENATE AND THE HOUSE OF REPRESENTATIVES OF THE STATE OF MONTANA REQUESTING THAT THE REVENUE OVERSIGHT COMMITTEE CONDUCT A COMPREHENSIVE STUDY OF THE PROPERTY TAX CLASSIFICATION SYSTEM AND EQUALIZATION WITHIN THE CLASSES OF PROPERTY IN THE STATE OF MONTANA.

WHEREAS, the property tax is a vital element in the taxation system in the State of Montana; and

WHEREAS, Montana's property tax classification system contains 11 separate classes of property that are assessed and taxed at different rates; and

WHEREAS, several actions by the United States Congress, particularly those relating to railroads and airlines, have raised legal questions about the operation of the property tax classification system in Montana; and

WHEREAS, there is an urgent need to study and resolve legal, administrative, and equity issues related to the property tax classification system and equalization within the classes of property used in Montana.

NOW, THEREFORE, BE IT RESOLVED BY THE SENATE AND THE HOUSE OF REPRESENTATIVES OF THE STATE OF MONTANA:

(1) That the Revenue Oversight Committee is requested to study the property tax classification system and equalization within the classes of property in Montana and to include in its study an examination of legal, administrative, and equity issues related to the classification system.

(2) That the Legislature provide funding so that the Revenue Oversight Committee may adequately staff this study with at least one full-time staff person, if necessary, and seek appropriate expert consultants to accomplish the purposes of the study.

(3) That the Revenue Oversight Committee report its findings and recommendations and any proposed legislation to the 49th Legislature.

SENATE JOINT RESOLUTION NO. 23

A JOINT RESOLUTION OF THE SENATE AND THE HOUSE OF REPRESENTATIVES OF THE STATE OF MONTANA REQUESTING AN INTERIM STUDY OF TAX CREDITS, TAX DEDUCTIONS, TAX EXCLUSIONS, AND TAX EXEMPTIONS; AND REQUIRING A REPORT OF THE FINDINGS OF THE STUDY TO THE 49TH LEGISLATURE.

WHEREAS, the Legislature attempts to encourage various activities and conduct by providing tax credits to persons or entities who engage in the encouraged activities or conduct; and

WHEREAS, the Legislature allows tax deductions, tax exclusions, and tax exemptions in an attempt to further the public policy of the State of Montana; and

WHEREAS, the effect on the State of the various tax credits, tax deductions, tax exclusions, and tax exemptions is significant; in the case of the investment tax credit, the cost is $10 million per year; and

WHEREAS, there is no review of the effect of the tax credits, tax deductions, tax exclusions, and tax exemptions to determine if they actually promote the public policy or encourage the activities and conduct they are intended to encourage; and

WHEREAS, many of the tax laws of the State of Montana are tied directly to the federal tax laws and a change in the federal tax laws automatically changes Montana's tax laws; and

WHEREAS, there is no review to identify the class of taxpayers that benefits from each tax credit, tax deduction, tax exclusion, and tax exemption.

NOW, THEREFORE, BE IT RESOLVED BY THE SENATE AND THE HOUSE OF REPRESENTATIVES OF THE STATE OF MONTANA:

That the Revenue Oversight Committee is requested to:

(1) identify each tax credit, tax deduction, tax exclusion, and tax exemption, their cost to the State, and their benefit to the State;

(2) identify the underlying legislative purpose of each tax credit, tax deduction, tax exclusion, and tax exemption;

(3) study the effectiveness of each tax credit, tax deduction, tax exclusion, and tax exemption in achieving its underlying legislative purpose; and

(4) identify the class of taxpayers who benefit from each tax credit, tax deduction, tax exclusion, and tax exemption.

BE IT FURTHER RESOLVED, that the Committee report the findings of the study to the 49th Legislature and, if necessary, draft legislation to implement its recommendations.

CHAPTER ONE

HISTORICAL DEVELOPMENT OF PROPERTY TAXATION: From Europe to Montana

INTRODUCTION

House Joint Resolution 31 requests that the Revenue Oversight Committee conduct a comprehensive study of Montana's property tax classification system. The resolution states that there is an "urgent need to study and resolve legal, administrative, and equity issues" related to the classification system.

This chapter is a beginning to that task. It examines several facets of property taxation: a brief overview of historical European property taxation; a general history of property taxation in the U.S. and Montana, with a focus on the Montana classification movement and subsequent events; and statistical information on Montana's place in the tax universe of 10 Western states. The areas covered in this background report constitute many of the essential details against which to judge current legal, administrative, and equity issues of Montana's property tax classification system. The purpose of this background report is to stimulate thought, discussion, and analysis of patterns and cycles that property taxation has undergone in Montana and elsewhere in order to better understand the specific issues of today.

HISTORICAL ROOTS OF PROPERTY TAXATION

European Developments

Taxing property is not a uniquely American idea. Indeed, the American roots of this form of taxation are buried deep in the history of the Western world. So too are the perplexing problems of defining "property", arriving at equitable assessments, and achieving efficient and fair tax administration. The following brief history outlines several key observations that have been made by students and observers of early European property taxation. While certainly not exhaustive, this history provides insight into the shifting historical nature of property taxation. This in turn should give us the perspective we need of the taxation forest -- that we might better appreciate the significance of each of the trees!

The first thing that must be said is that generalizations are often dangerous. European civilization developed slowly over many centuries, and meaningful taxation patterns are difficult to distinguish.

Having commented on the dangers of generalization, we now face with courage (and caution) some generalizations about European property taxation (summarized from articles by Sumner Benson and Arthur D. Lynn, Jr.):

1) Property taxation was based upon an ability to pay concept. A historian of the English property tax explained the use of property taxation this way (Cannan, History of Local Rates in England, (2nd ed.) (1912), pp. 22,23.):

> It seems quite clear that in the fourteenth and fifteenth century the accepted view was that each inhabitant should pay according to his ability or substance, for in those days ability and substance meant much the same thing: the man who has a large income without having a large capital is a

> product of modern civilization. Something in the nature of a valuation list soon sprang up, not because there was as yet any idea that the things of which a man's substance consists ought to be rated [taxed], but because the assessors wanted some kind of guide as to the relative ability or substance of the rate payers. In a purely agricultural community, where every person of ability to pay is a farmer, nothing can be more natural than that the assessors, in forming their estimate of relative ability, should consider the number and quality of the acres cultivated by each and perhaps also the number of sheep and cattle pastured. In a town an equally obvious guide as to the substance of the inhabitants is afforded by the size or value of the houses occupied. When this has once become the settled custom, it is supposed by a natural confusion of mind that the acres and the houses are taxed, and any attempts to carry out the original principle of rating according to ability derived from every source are strenuously resisted by the parties interested.

Likewise, the German "bede" was a tax on rural land and improvements. The land and improvements were regarded as a measure of the income-earning ability of the owner of property. In fact, the German word for "property tax" -- vermoegenssteuer -- literally means "capability tax".

2) The property tax in primitive society begins as a tax on land and then extends to improvements. Later, as society develops and commercial and industrial activities expand, societies try to extend the tax to personal property -- both tangible and intangible. Athens levied a land tax as early as the 4th century B.C. The levy also applied to houses, slaves, cattle, furniture, and money -- although the levy on such personal property gradually slipped out of the assessment roles.

Early Roman property taxes rested solely on land but later sought to reach personal property. Like the Greeks before them, the Romans were not very successful in reaching the latter category and the usefulness of the tax eventually ended.

3) Property taxes were seldom universal to all property. Both rural and urban areas made few attempts to tax all property -- certain items were commonly exempted, such as household goods. Sometimes certain categories of property were exempt (such as movables) because the owner's land was already taxed. Sheer political power also insured that certain broad categories of property would not be taxed, for example, that owned by the nobility or clergy.

4) Alternative taxation existed within the property tax concept. Taxation of movables for persons who owned no land was sometimes used. Some German cities levied a "head" tax or business operating tax on persons who owned no property.

5) The shifting characteristics of Continental and English property taxation were due in large part to constant attempts to keep pace with changing methods of earning income and accumulating wealth. Whenever the effectiveness of the property tax to reach wealth diminished or ceased, Europeans adopted supplementary or alternative levies.

A recent student of property taxation summarized much of the early development of property taxation in this way:

> In its earliest stage the property tax is essentially a tax on land. Thus it can easily serve as the primary levy in a simple economy, where almost all income is derived from land ownership.
>
> But as the economy grows more complex, the relative importance of land use declines and that of commercial transactions and industrial production grows. The concept [of property] must, therefore, be extended to include both moveable property and "intangibles" (money, credit notes, securities). Frequently the property tax has failed to reach such property, thus rewarding the commercial groups at the expense of the landed. Such a situation, which almost invariably results in regressive taxation, has forced many countries

> to adopt supplementary taxes better designed to reach the less visible forms of wealth. (Benson, p. 12.)

Benson and others have seen this property tax cycle from the Greeks and Romans, to Germany and England, and from colonial America to the present. Parts of the pattern seem to recur in modified form.

PROPERTY TAXATION IN THE UNITED STATES TO 1800

European influences on American property tax practices came indirectly through the English tax system. While the imprint of historical influence can be found, one does not suggest the American systems are copied unchanged from the past. The property tax system in use in the United States today probably never existed in Europe and certainly did not exist in England at the time of the American Revolution. (Jensen, p. 19.)

Each colonial government had a different idea as to what constituted "property" and what property should be taxed. Generally, land was the major base of taxation in the colonial period and taxation of buildings constituted a supplement to this base. Tangible personal property was generally taxed throughout the colonies. Little taxation of intangibles took place. Property taxes were supplemented by poll taxes and "faculty" taxes -- intended to reach professionals whose income was dependent on their innate personal traits, not tangible property. (Benson 25-27.) The developing mixture of taxes seemed to represent colonial legislatures' attempts to make ability to pay the basis of taxation in a rapidly changing society.

Although there appeared to be general agreement by 1796 as to the objects of taxation (land, farm stock, some forms of

personal property, and business and professional ability), colonial governments displayed a great diversity in assessments, tax rates, and tax practices.

THE GROWTH OF THE GENERAL PROPERTY TAX IN THE 19TH CENTURY

The general property tax is a tax on all property regardless of its nature, imposed throughout a taxing jurisdiction at a uniform rate. By 1800, only four states had tried to place taxes on all property, but such efforts would grow steadily during the 19th century. (Benson p. 29.) Concurrently there were increasing efforts to levy the tax at a uniform rate on all property. The movement took its force from prevailing ideas about democracy and equality and a belief that the weight of taxation should rest "equally" on all. By the end of the 19th century the demand for "uniformity and universality" in taxation became imbedded in the constitutions of 21 states. (Benson p. 31.) Thus, by the end of the nineteenth century the American experience with property taxation had developed from early colonial property taxation that began with land and gradually extended to other types of property until all property (or at least most) was legally taxable.

The basic assumptions that lay behind the general property tax movement were that taxation should reflect ability to pay, that such ability could be measured by the selling price of an individual's total property holdings, and that taxation could reach all property. (Benson, 35)

MONTANA'S PROPERTY TAXATION SYSTEM 1889 TO 1919 -- THE GENERAL PROPERTY TAX SYSTEM

Montana became a state in 1889. When it joined the Union, it brought with it much cultural baggage from older settled

regions of the United States. Taxation policy was no exception.

Montana's 1889 Constitution, which came to Montana via Colorado and Pennsylvania, contained the following language regarding taxation:

> The necessary revenue for the support and maintenance of the state shall be provided by the Legislative Assembly, which shall levy a uniform rate of assessment and taxation, and shall prescribe such regulations as shall secure a just valuation for taxation of all property, except that specifically provided for in this article. (Section 1, Article XII. Emphasis added.)

The Constitution further specifically defined "property" to "include money, credits, bonds, stocks, franchises and all matters and things (real, personal, and mixed) capable of private ownership . . . ." (Article XII, Section 17.)

In short, Montana had a general property tax system that legally required all taxable property to be assessed at full cash value and taxed at uniform rates. (Section 2502, R.C.M. 1907.)

But there were two provisions in the 1889 Constitution that prevented the operation of a pure general property tax system.

The first such provision in the Constitution created a certainty. Article XII, Section 3, required that all mines and mining claims would be taxed at the price paid the United States plus the annual net proceeds. The Constitution made it clear that this class of property was not to be treated in the same manner as other property. This exception would be much debated in the second decade of the 20th century and was often in the background of Montana tax discussions.

The second provision created a contradiction. Article XII, Section 11, stated:

> Taxes shall be levied and collected by general laws and for public purposes only. They shall be uniform upon the same class of subjects within the territorial limits of the authority levying the tax. [Emphasis added.]

This language would seem to have allowed legal discrimination among tax rates applicable to different classes. Until 1919, however, the law was not generally used or understood in such a context.

SIGNS OF TROUBLE

Taxation of property by the newly created state of Montana got off to a shaky start. The State Board of Equalization, composed of ex officio state officers, organized itself in March of 1890. The legislative session of that year -- which the Board described as "fruitless and barren" -- had adjourned without providing any legislation. There were no laws to guide state or county officials in the field of taxation. The State Board had only the language of Montana's Constitution to go by.

Without laws -- but trusting that the willing people of Montana would be "obedient to the necessary requirements of their government" -- the State Board set about adopting rules for its own governance "in adjusting and equalizing the valuations of the taxable property in and among the several counties . . . and assessing certain property belonging to railroad companies . . ." (First Annual Report, pp. 4-5.)

There was a period of quiescence as the Board went about its tasks of administration and equalization --

until 1896. In that year, the Board was enjoined from proceeding with or completing the task of equalization. The Supreme Court ruled (in The State of Montana ex rel. R.C. Wallace, et al. vs. The State Board of Equalization) that the acts of the State Board in increasing and decreasing the value of property in various counties and thereby changing the total taxable value of the state were unconstitutional. According to the Court, the State Board of Equalization could not increase the total statewide taxable value when it made adjustments.

While the State Board vigorously complained about the Court decision and lectured the Legislature about "uniform taxation and just valuation", the decision remained unchanged. The constitutional restrictions "limited and restricted the board's power of supervision, review and equalization, [to such an extent] that but little could be accomplished." (Seventh Annual Report, Ninth Annual Report, and John Edgerton, "Montana Problems", in Annual Proceedings of the National Tax Association, 1919, p. 103.) After 1898, and until the early 1920s, the State Board of Equalization appears to have confined its efforts to assessing railroads and apportioning value to counties. (The Board even discontinued issuing annual reports between 1906 and 1920).

THE BREAKDOWN OF THE GENERAL TAX SYSTEM

In 1898 the State Board of Equalization warned of "glaring defects in valuation of real estate and personal property which should be rectified to promote the uniformity of assessment and just valuation". (Ninth Annual Report, p. 10.) The Board even went so far as to suggest that if the Legislature could not solve the problems of uniformity of assessments and

just valuation that a complete revision should be made in Montana's tax structure. The Board recommended that local governments be given the entire receipts from the taxation of real and personal property. The state, the Board recommended, would derive its revenue from license taxes on coal, ore, and lumber, the gross receipts of railroads, express companies, and street railroads, and from a graduated income tax on individuals and corporations. The motive for this suggestion lay behind the fact that the state was constitutionally limited to not more than 2½ mills on the value of property -- therefore, stagnant property values would severely reduce state revenues. (Ninth Annual Report, p. 10.) The Legislature apparently ignored the recommendations.

A decade passed, and the total taxable value of the state doubled -- from $142 million in 1899 to $280 million in 1909. In his messages to the Legislatures of 1909 and 1911, Governor Edwin L. Norris noted that property in the state was not assessed uniformly. He believed stricter laws were necessary.

By 1913 the situation had become serious enough that the Legislature created a tax commission consisting of the Governor, the Attorney General, the Secretary of State, the State Treasurer, the State Auditor, and one other member to be known as the State Tax Commissioner. The Commissioner was to be appointed to a single six-year, nonrenewable term and was to be aided in his task by a three-member Board of County Appraisers in each county. The county appraisers -- one of which was to be a farmer; another a merchant -- were to be appointed by the Commissioner. The law charged the Board of County Appraisers with responsibility for

fixing the "true value" of all property within their county. (Chapter 75, Laws of 1913.)

A full-time Commissioner was to be the key to this attempt at reform. The Commissioner's duties made him responsible for general supervision of the taxation system in the State.

This attempt did not work. While the First (which was also the last) Biennial Report of the State Tax Commissioner pointed out wide discrepancies in property values established by local assessors and other weaknesses of the general property tax system, the State Tax Commission still did not have actual authority to supervise, review, and equalize assessments between counties. Governor Stewart characterized the law creating the Commission as "ambiguous and uncertain"; he recommended that the Legislature consider a "suitable constitutional amendment" that would correct the state's taxation system. (House Journal, Message of the Governor, p. 15.)

The 1915 Legislature abolished the Commission and proposed a constitutional amendment to enlarge the powers and duties of the State Board of Equalization to supervise, review, and equalize taxable valuations. The amendment, which sought to end the impotence imposed by 1896 Court interpretations, read:

> The Board of County Commissioners of each county shall constitute a County Board of Equalization and the Governor, Secretary of State, State Treasurer, State Auditor and Attorney General shall constitute a State Board of Equalization. The duty of the County Board of Equalization shall be to adjust and equalize the valuation of taxable property within their respective Counties and all such adjustments and equalization may be supervised, reviewed, changed, increased, or decreased by the State Board of Equalization. The

> State Board of Equalization may adjust and equalize the valuation of taxable property among the several counties and the different classes of taxable property in the same and in the several counties and between individual taxpayers; supervise and review the acts of County Assessors and County Boards of Equalization; change, increase or decrease valuations made by County Assessors or equalized by County Boards of Equalization and has such authority and may do all things necessary to secure a fair, just and equitable valuation of taxable property among the counties and between the different classes of property and individuals. (Emphasis added.) (Chapter 47, Laws of 1915.)

The electors adopted the amendment at the general election held in November 1916. The 1917 Legislature considered legislation to implement the constitutional amendment. Both the House and Senate conducted investigations during the legislative session to consider tax problems, particularly deficits in state revenue created by the constitutional property tax limit of 2½ mills for state purposes. But the provisions to implement the 1916 Constitutional Amendment would have to wait -- the Legislature restricted its actions to meeting the deficits by enacting a series of license taxes on three classes of corporations, private car lines, and express companies. The revenue generated from the license taxes (approximately $1.4 million for 1917 and 1918) was dedicated for the exclusive use of state government. This began a trend moving the state away from property taxation as a source of state revenue.

The Legislature must have realized that the license taxes were a temporary "fix" for the state but that they did not resolve problems of the general property tax system or correct a popular conception that the mining industry was not paying its fair share of taxes. Before the 1917 Legislature adjourned it created a temporary tax and license commission to conduct a study of the Montana tax situation during the 1917-1919 interim. (Chapter 73, Laws of 1917.)

Twenty-five thousand dollars was appropriated for the Commission's activities.

THE TEMPORARY TAX AND LICENSE COMMISSION

The Tax and License Commission consisted of three members: Charles R. Leonard, a Butte lawyer, former state senator, and chairman of the Commission; William Lindsay, a rancher from Glendive; and David Hilger, a Lewistown banker. The Legislature asked the Commission to

> . . . inquire into the assessment and relative amount of taxes paid upon all forms of property in the several counties ... consult and cooperate with the State Board of Equalization, with the view of gathering evidence and information and making recommendations which will be of assistance to said State Board of Equalization, in the performance of its duties, in securing a fair, just and equitable valuation of taxable property in the State, in adjusting and equalizing the valuation thereof among the several counties, and in raising the necessary revenue for such purposes . . .

The Commission and its staff were very busy during the 21 months from the creation of the Commission to the issuance of its final report in November 1918. Members met several times with the State Board of Equalization and with various state and county officials, attended state and national conferences that discussed taxation issues, and visited with officials of other states regarding their tax systems. [See Appendix A for comparisons of Montana's classification system with that of Minnesota and North Dakota.]

The Commission's Final Report was a primer on how the property tax system worked in Montana in 1918. The Report noted that

> Montana has what is commonly known as the General Property Tax. By this we mean that all property is required to be assessed equally, and pay the same rate of taxation. Section 2502 of the Revised Codes of Montana, 1907, provides, that: "All taxable property must be assessed at its full cash value." (Report, p. 9.)

Having reminded its audience of what the law required, the Report went on to say that

> . . . the provision of our statute in regard to the assessment of all property at its full cash value has become a dead leteter [sic], not only in Montana, but in every state that has attempted it . . . . Instead of all property in Montana being assessed at its full cash value, we find a great lack of uniformity, not only as between different counties but also as between individuals, and almost a complete disregard of the statutory provisions relating to full value. (Report, p. 10.)

The Report laid part of the blame for the "complete disregard" of statutory provisions upon elected county assessors:

> In the face of the positive statutory enactment requiring assessment at full value, and in the face of instructions from the Attorney General that the assessment must be made in that manner, the assessors meet every year, resolve themselves into a sort of legislative assembly and proceed to fix the values at which different species of property shall be assessed. (Report, 10.)

The lack of uniformity found by the Tax and License Commission caused by the disregard for assessing at full cash value and the hiding of property was characterized in July of 1918 by a reporter for the Hamilton Western News as follows:

> The report of the state tax commission, which will be made at the forthcoming session of the legislature, will disclose some amazing facts with regard to the state's revenues. For instance, while there is known to be something like $150,000,000 on deposit in various banks[,] solvent credits are assessed at but $4,500,000 and 60 per cent of this taxed money is in Silver Bow county; there are 11

> counties in Montana, according to the tax rolls, which take toll of time by looking at the sun and guessing; and while there are nearly 50,000 automobiles in the state, according to the numb r [sic] of licenses issued, but 12,000 have been returned [assessed] by the assessors; there are nine Montana counties in which there is not a single wheeled vehicle, according to the assessment. (Western News, July 25, 1918, p. 2.)

The newspaper reporter was summarizing comments made by David Hilger, a member of the Tax and License Commission. In an interview with the paper, Mr. Hilger covered a wide range of tax inequity problems. In regard to banks, he said that if the State of Montana had "some equitable method of applying taxes to cash and solvent credits we could encourage our people to admit their wealth and thereby bear their just part of the support of government by direct taxation." (Western News, July 25, 1918, p. 2.)

In regard to automobiles, Mr. Hilger complained:

> . . . something is radically wrong or the assessors would find more of the machines. We must find some way to cure this distressing attack of assessorial myopia when it comes to seeing automobiles. We don't want them to see 50,000 if there is but 40,000, but no more do we want them to see only 12,389. (Western News, July 25, 1918, p. 2.)

"Assessorial myopia" was not limited to automobiles. Mr. Hilger outlined the lack of assessment on other items:

> Let us take another item that all will understand the absurdity of it when the facts are set forth. There were watches and jewelry in the state in 1917 valued at but $115,105 and there were 11 [,] or more than one-fourth of all the counties, who reported not a single watch and not an item of jewelry within the county. How in the name of Peter Pan, the Great Jehovah and a few other celebrities do they mark time in those 11 counties? . . .

> . . . . Nine counties in our state are credited by their assessors with not a single carriage or wagon . . . . Missoula county, so the assessor's report for 1917 say[s], had no farming machinery, harness or robes. (Western News, July 25, 1918, p. 2.)

David Hilger's comments pointed out two primary findings of the Tax and License Commission: a great deal of property in Montana was escaping assessment because it was not (or could not be) listed by assessors; and property that made the list was being severely underassessed. The Tax Commission's investigations showed that the average rate of assessment compared to full value in the counties for land was about 30%, cattle were 45%, horses and mules were 52%, hogs were 18%, and bank stock was 65%.

The Commission also found that there was a "great lack of uniformity" and "great differences in assessments upon the same classes of property". (Report, p. 11.) The range of averages for the various counties was sometimes enormous. For instance, the assessment on first-class grainland varied among counties in 1918 from $5.21 to $46.29 per acre; first-class hay land from $10.00 to $26.62 per acre; thoroughbred horses from $81 to $292; automobiles from $133.85 to $325. (Report, p. 11.)

The Commission came to several conclusions -- that the system of taxation in Montana was a "failure", resulted in "unjust discrimination", and was "utterly inadequate". (Report, p. 11.) Specifically, the Commission argued that the operation of a general property tax in Montana was "indefensible, both from the standpoint of producing uniformity and on account of its total failure of enforcement." (Report, p. 10.) The Commission's ultimate judgment was that Montana should abandon the general property tax system in favor of a classified system -- a tax system in which various classes of property are either assessed for tax

purposes at different percentages of value or taxed at different rates.

THE COMMISSION'S ARGUMENTS IN FAVOR OF CLASSIFICATION

The Commission recommended several modifications to Montana tax law that were meant to clarify the role of a central authority in supervising the administration of Montana's tax laws. It also recommended a bill that would provide for the classification of all taxable property. It is this recommendation with which we are most concerned here.

The Commissioner's classification bill divided property into seven classes with a different tax rate applied to the true and full value of each class. The classes were as follows:

> Class One. The annual net proceeds of all mines and mining claims, after deducting only the expenses specified and allowed by Section 2565 of the Revised Codes of Montana, 100 per cent of true and full value.
>
> Class Two. All household goods and furniture, including clocks, musical instruments, sewing machines, wearing apparel of members of the family and all personal property actually used by the owner of personal and domestic purposes or for the furnishing or equipment of the family residence; all agricultural and other tools, implements and machinery, gas and other engines and boilers, threshing machines and outfits used therewith, automobiles, motor trucks and other power-driven cars, vehicles of all kinds, boats and all water craft, harness, saddlery and robes -- 20 per cent of true and full value.
>
> Class Three. Live stock, poultry and all agricultural products; stocks of merchandise of all sorts, together with furniture and fixtures used therewith -- 33 1/3 per cent of true and full value.
>
> Class Four. All land, town and city lots, with improvements; manufacturing and mining machinery,

fixtures and supplies -- 30 per cent of true and full value.

Class Five. All money and credits, secured or unsecured, including all state, county, school district and other municipal bonds, warrants and securities without any deduction or offset; provided, however, that the terms moneys and credits as herein used shall not embrace the moneyed capital employed in the banking business by any banking corporation, association or individual in this state -- 7 per cent of true and full value.

Class Six. The shares of stock of national banking associations, and the moneyed capital employed in conducting a banking business by any other banking corporation, association or individual in this state. Such moneyed capital to be ascertained by deducting from the moneys and credits of such banking corporations, association or individual, the amount of the deposits and any indebtedness representing money borrowed for use in said business, and the value of the shares of any national banking association, to be ascertained by deducting the value of all real estate of such association -- 40 per cent of true and full value.

Class Seven. All property not included in the six preceding classes -- 40 per cent of true and full value.

Why did the Commission group the above properties into these classes and apply these percentages? According to the Commission, it was because "each are fair and do no injustice to any class." (Report, p. 22.)

There was also a practical reason -- the classifications and percentages followed somewhat the de facto situation that existed in Montana. In other words, the bill that the Commission was recommending legalized the existing situation, but it was also an attempt to get legislative control over the taxation system. Thus, the Commission had called attention in its report to the fact that:

> . . . we have a sort of classification of property in Montana regulated, not by the Legislative Assembly, but by the assessors and the State and County Boards of Equalization. We believe a classification should be made by the legislature. (Report, p. 10.)

While the Commission seemed to endorse the de facto classification system, it also emphasized the principle that the legislature should control tax policy.

Perhaps more importantly, the Commission endorsed prevailing principles of property tax classification. One such principle was taxation based on ability to pay, according to productivity and benefits received. The Commission said that it had

> . . . attempted in the . . . classification[s] to follow the precedent in the so-called classification states, that property which produces the smallest income should bear the lowest rate of taxation. (Report, p. 22. Emphasis added.)

In support of its classification recommendation the Commission cited numerous national tax experts and economists who vigorously criticized the theory and practice of the general property tax system and favored a classified tax system. These experts generally argued that not all property represented the same ability to pay, that the uniform rule of general property taxation ignored differences in income produced by various property, and that the general property tax did not recognize the tax shifting ability of certain property. The general property tax system, with its emphasis on uniformity and equality, according to these experts, was unfair. (Report, passim, pp. 23-25. Experts cited: Frank Roberson, Mississippi tax expert; Professor Edwin R. Seligman, Columbia University; William A. Robinson, Tax Commissioner of Kentucky; Professor Charles J. Bullock, Harvard University; Professor Richard T. Ely. See also

Leland, The Classified Property Tax in the United States, pp. 14-19.)

In Montana the members of the Tax and License Commission felt that while the general property tax system had been practical and workable in 1890 when taxable property in Montana consisted almost entirely of land, improvements, livestock, and other tangible personal property, by 1918 the tax system was not compatible with the complex nature of a mixed agricultural, commercial, and industrial society. The Commission's report stated the situation in this manner:

> Since 1889 Montana has made material progress in all directions. New classes of property have come into existence. There are now, as never before, invisible and intangible personal properties of immense value and volume that are unknown and undiscoverable by the assessors under the present law.
>
> The Montana tax burden under the general property tax has been shifted year by year to real estate and other property equally "tangible" to the assessor . . . .
>
> Instead of advancing hand and hand with personal property, real estate and improvements have increased six times in their assessed valuation [between 1890 and 1918] while the personal property portion noted [excluding livestock and net proceeds] has increased only two and one-third times.
>
> It requires no profound wisdom to understand who is paying the taxes in Montana, nor why the tax burden is heavy and unequal on the owners of tangible property. (Report, pp. 26-27.)

The Tax and License Commission recommended a package of five bills to the 1919 Legislature that were designed to provide improved property tax supervision, administration, and equalization. Most importantly, in the Commission's opinion, a classification bill was the "basic and all-important" change necessary "to secure equality". Under the

classification law "[t]he necessity for concealing intangibles to prevent loss of principle will not then exist." In other words, if the law was reasonable, all property could be expected to be reported and taxed -- thus reducing the burden on real estate and tangible personal property.

CLASSIFICATION AND THE 1919 LEGISLATURE

Almost nothing is known about the inner workings of the 1919 Legislative Assembly. Except for the Journals and Session Laws of 1919, no archival material from the Session is known to exist. Insights into the workings of the 1919 Session are therefore sketchy and drawn from secondary sources.

Republican Representative C.A. Rasmussen carried the five tax bills recommended by the Tax and License Commission. Rasmussen was a real estate broker from Glendive.

The Rasmussen package was assigned to a Joint Senate and House Taxation Committee for study, as was the Report of the Tax and License Commission. In a 2-week period prior to February 3, 1919, the Joint Committee held eight hearings on the Report and Rasmussen's bills. (Great Falls Tribune, February 3, 1919, p. 2.) No record of the hearings is known to exist. We do know that the hearings were attended by

> . . . county assessors and county commissioners, . . . tax experts from the federal railway administration, a committee from the cooperators' congress, . . . representatives of the Mountain States Telephone and Telegraph company and various other tax experts from about the state who desired to be heard upon the question. (Great Falls Tribune, February 3, 1919, p. 2.)

There must have been opposition to the classification aspects of the Rasmussen legislation expressed at the

hearings. A committee of the Cooperators' Congress was the most likely to have disagreed with classification. The following newspaper excerpt summarizes support for the general property tax system not otherwise heard in the Report of the Tax and License Commission. While somewhat lengthy, it is worth quoting in full:

> Members of the legislative and resolutions committee of the Montana Union, American Society of Equity recommended many changes during the co-operators' congress held here [Great Falls, Montana] last week, one of the most important being a recommendation by the legislative committee favoring the present general property taxation system in use in Montana and urging reform in taxation. This recommendation was as follows:
>
> "We most emphatically condemn the monstrous system of taxation by menace of which the public burden in the state of Montana has heretofore been lifted from the shoulders of the mining, banking, and other corporate interests and heaped as double burden upon the backs of the long-suffering farmers. We protest against the pending effort of the state tax commissioners to fasten this unspeakable injustice upon the state for all time to come. We repudiate the falsehood that an unholy system may become righteous, if administered by a $30,000 tax commission. And we demand that there shall be infused into the tax system of the state at least a little of fundamental economic justice.
>
> "If the resources of the mines are to be exempt from taxation, if the mines are to be taxed upon their proceeds only, then we insist that the resources of the farmers must also be exempt and that they, too, shall be taxed upon net proceeds only.
>
> "If the Montana farmer must continue paying taxes upon the sum total of all his debts, as well as upon the sum total of all his property, then we insist that the Montana bankers must also pay taxes upon all his debts as well as upon all his property.
>
> "For the purpose of meeting the present situation in Montana we recommend the increase of the present corporation license tax to not less than 2 per cent.
>
> "As a basis for further constructive legislation, we indorse the following principles:

"1. A graduated system of taxation upon incomes and inheritances.

"2. A special tax on all lands held for speculative, rather than for productive purposes.

"3. A uniform general property tax not in excess of 10 mills, and levied in such a manner as to reach every piece of property in the state.

"4. The abolition of every form of double taxation."

The Montana chapter of the American Society of Equity was arguing that the classification system did not address the more fundamental issues of corporate and mineral taxation in Montana. Their attack on provisions of the 1889 Montana Constitution which prohibited the Legislature from taxing mineral deposits except on a net proceeds basis was a familiar argument to Montana legislators. Indeed, it was during the middle of the 1919 Legislative Session that an economics professor was fired from Montana State University (Missoula) for publishing a book entitled The Taxation of Mines in Montana. The book purported to reflect a substantial imbalance between the taxation of farmers and corporations.

While there was obviously some disagreement about the package of bills that Representative Rasmussen sponsored, once the hearings were over and a "few minor amendments" were made by the committee, the House quickly approved the bills:

> All the members of the legislature from the earliest days of the session have discussed this proposition more than any one other subject, with the result that when the measures came up for formal consideration in the house yesterday the five bills were disposed of without much debate or serious opposition in about an hour and a half. (Butte Miner, February 11, 1919, p. 4.)

The "hour and a half" floor debate concentrated on Rasmussen's bills to provide a permanent tax commission and

the classification bill. The other three of Rasmussen's bills were approved by the House without debate or opposition. According to newspaper accounts the debate on the classification bill (House Bill No. 30) revolved around changing various percentages applied to classes of property, but members of the Legislature did not publicly question the wisdom or principle of classification itself.

Representative Samuel J. Crouch, a banker from Three Forks, attempted to have personal wearing apparel stricken out of the bill. He was informed that the Constitution required all property to be taxed and that striking apparel out of the 20% class would only move it to the 40% class. Representative Iver M. Brandjord, a banker from Ronan, failed to attach an amendment that moved the percentage applicable to money and credits from 7 to 10 %. Another unsuccessful attempt was made by J. A. McAfee, a farmer from Kalispell, to decrease the percent on livestock, agricultural products, and stocks of merchandise from 20% to 15%. The final attempt to change House Bill 30 came from a Deer Lodge attorney, Edward Scharnikow. Mr. Scharnikow was worried that the classification of lands and city property would result in a loss of revenue due to the 30 %rate. He was assured that the Commission "had taken into consideration the assessments of the various cities and . . . this would not result in much of a change from present revenues." (Great Falls Tribune, February 11, 1919, p. 2.)

The classification bill passed both the House and the Senate by comfortable margins. (House Journal, 1919, p. 548; Senate Journal, 1919, p. 280.) Montana joined the ranks of other states with a classified property tax system.

One observer of the Montana classification law noted in 1930 that the "fiscal aspects of the Montana classified property tax are not encouraging." He added that the "classified tax . . . may be acceptable in Montana as a measure of equity, but cannot be advocated solely as a fiscal device." (Jensen, Property Taxation in the United States, p. 182-183.)

By one measure, tax assessment had improved markedly between 1918 (general property tax system) and 1919 (classified system). The table (Classified Property Tax, p. 251) below demonstrates that assessed value of all property in Montana increased in 1919 almost three times its 1918 level.

TABLE 1

ASSESSED VALUES OF PROPERTY IN MONTANA

1917-1926

(In millions of dollars)

Year	Total assessed valuation	Assessment by Classes of Property						
		Class I	Class II	Class III	Class IV	Class V	Class VI	Class VII
		Annual net proceeds of mines	Household goods, agr. implements, autos, etc.	Livestock, agr. prod., store fixtures, etc.	Real estate and improvements, mfg. machinery, etc.	Money and credits	Nat'l bank stocks; moneyed capital	All other property, including public utilities
1917*	$582	$45	$18	$86	$318	$9	$13	$90
1918*	589	17	24	97	338	8	13	88
1919	1701	31†	66	228	1044	64	22	267
1920	1668	6	62	182	1077	63	22	245
1921	1582	4	58	143	1041	57	20	267
1922	1471	4	49	119	984	50	17	262
1923	1470	10	45	110	971	49	16	272
1924	1397	9	45	104	940	45	11	245
1925	1359	9	49	106	893	43	12	247
1926	1376	17	54	115	884	47	10	240

* Assessment under general property tax.

† Decline in assessments due to decline in net income of firms in the copper industry, to fall in price of copper, and to changes in methods of assessing and computing net proceeds.

SOURCE: Cited in: Jim Oppedahl, "Montana's Property Tax Classification System", Memorandum to the Revenue Oversight Committee, October, 1983, Helena, Montana.

While one could be optimistic about the increased valuations, the classification percentages applied to the property values actually resulted in a slight loss of taxable value. The following table demonstrates the loss of taxable value in each class of property except classes 4 and 7:

TABLE 2

TAXABLE VALUES OF PROPERTY IN MONTANA
1917-1928
(in million dollars)

Year	Total	Class 1	Class 2	Class 3	Class 4	Class 5	Class 6	Class 7
1917	582	$ 51	$ 18	$ 89	$311	$ 10	$ 14	$ 90
1918	589	23	24	98	333	9	14	88
1919	526	5	13	76	312	5	9	107
1920	514	8	12	61	322	4	9	98
1921	496	9	12	49	307	4	8	107
1922	465	13	10	40	287	4	7	105
1923	467	13	9	37	288	3	7	109
1924	441	12	9	35	279	3	5	98
1925	430	9	10	35	268	3	5	99
1926	436	17	11	38	265	3	4	96
1927	433	15	12	37	263	4	2	101
1928	428	9	13	39	262	3	2	101

SOURCE: Cited in: Jim Oppedahl, "Montana Property Tax Classification System", Memorandum to the Revenue Oversight Committee, October, 1983, Helena, Montana.

That the net result of the change to classification resulted in taxable values close to the previous values indicates that the Tax Commission was very close in its estimates of undervaluation in Montana -- or, that the county assessors adjusted full cash values upwards so that when the new percentages were applied, the resulting taxable values would be about the same as they were under the general property tax. (Property Taxation and the Montana Property Classification Law, Montana Legislative Council: 1964, p. 16.)

Another manner of looking at the effect of the classification law is to present the changes from 1917 to 1926 in the form of each class's percentage of taxable value by year. The following table presents this information.

TABLE 3

PERCENTAGES OF TAXABLE VALUATIONS IN MONTANA BY PROPERTY CLASS 1917-1926

Year	Class 1	Class 2	Class 3	Class 4	Class 5	Class 6	Class 7
1917	8.7	3.2	15.3	53.3	1.6	2.3	15.5
1918	3.8	4.1	16.6	56.6	1.5	2.3	15.0
1919	0.9	2.5	14.5	59.3	0.9	1.7	20.3
1920	1.6	2.4	11.8	62.6	0.9	1.7	19.1
1921	1.9	2.4	9.9	61.9	0.8	1.7	21.6
1922	2.9	2.1	8.6	61.6	0.8	1.5	22.5
1923	2.9	2.0	7.9	61.7	0.7	1.5	23.3
1924	2.8	2.1	7.9	63.2	0.7	1.0	22.3
1925	2.2	2.3	8.2	62.4	0.7	1.1	23.0
1926	4.0	2.5	8.8	60.9	0.8	1.0	22.1

SOURCE: Cited in: Jim Oppedahl, "Montana's Property Tax Classification System", Memorandum to the Revenue Oversight Committee, October, 1983, Helena, Montana.

This last table provides perhaps the clearest picture of what happened with taxable values between 1917 and 1926. If one assumes that assessment practices were consistent between classes during the period (which is undoubtedly an unsafe assumption), the percentages indicate that the property tax burden shifted toward land and improvements, stocks and merchandise, fixtures and supplies, and to the class of all other property (class 7). Intangibles in class 5, a major thrust of the classification reform, actually decreased their share of the taxable value.

The bad showing made by intangibles in Montana was blamed by Simeon Leland on inadequate administration, particularly by local authorities. Leland also thought that the Montana classifications were "illogical" and that "the entire [Montana] plan seems too complex." (Leland, p. 145, 256-257.)

Other factors that explain declining taxable value probably had little to do with the classification system itself. The year 1919 was the beginning of several bad years for both copper prices and demand. Net proceeds reflected this decline. The postwar depression also severely hit farming and manufacturing industries in Montana. Many of these industries had severe ups and downs throughout the 1920s and 1930s. (See Leland, pp. 251-252.)

CHANGES THAT HAVE AFFECTED THE CLASSIFICATION SYSTEM SINCE 1919

Appendix B provides a year-by-year breakdown of legislative changes to the property tax classification law since 1919. Changes have accelerated in the past two decades and have been concentrated in the areas of exempting property from taxation, placing property in a lower tax class, or creating a lower percentage within a class for certain kinds of property.

Other changes to the system have been more subtle. This section of the report will attempt to briefly outline the contours of the classification system and the major issues that have concerned the system.

The first serious issue to confront the classification system was a court challenge to the constitutionality of the classification act. The act was affirmed by the court, as

was the Legislature's duty to provide a uniform statewide system of assessments. (Hilger v. Moore, 56 Montana 146, 82 P 477, 483 (1919)). The classification law was in place and secure.

Next, the Legislature began a series of changes in the state taxation system, many of which directly affected the property tax system. In 1921, the Legislature greatly expanded the administrative duties of the State Board of Equalization by approving several license taxes on gasoline, coal, oil, cement, and metalliferous mines. In addition to these added duties, the Legislature centralized tax administration under the State Board of Equalization. The Legislature transferred the inheritance and corporation license tax from the State Treasurer's Office to the Board, and it also transferred the duty of assessing net proceeds of mines from county assessors to the State Board. (These changes would mean that by 1924 about 55% of the state's general fund revenue would come from license taxes and fees. (First Biennial Report of the Board of Equalization, p. 14.)

At the same time the Legislature referred to the state's voters an amendment to the Constitution that provided for a State Board of Equalization "consisting of three members to be appointed by the Governor and approved by the Senate", rather than ex officio state officers. The amendment was approved in November 1922 by a "substantial majority". (First Biennial Report of the State Board of Equalization, p. 10.)

Almost the first act of the 1923 Legislature was to provide statutory powers and duties for the new State Board of Equalization. Significantly, the Legislature gave the new State Board the power to "prescribe rules and regulations, not in conflict with the constitution and laws of Montana, to govern county boards of equalization and the assessors of

the different counties in the performance of their duties." The Board was even given the power to require county attorneys to assist it in prosecuting county assessors who neglected their duty. (Chapter 3, Laws of 1923.) This was apparently a compromise: the county assessors would retain their status as constitutionally elected local officials, but if they did not perform their prescribed duties, they would face fines and removal from office.

By 1923 there existed at the state level a seemingly powerful, centralized agency that had the authority to carry out legislative tax policies and direct state taxation administration for both the classified property tax system and the new license taxes. Under such a system it should be possible to value property at the legislatively required "full cash value".

> However, neither the statutory changes embodied in the 1919 classification law nor the . . . constitutional amendment touched the fundamental problem of tax assessment: county assessors were still elected by local citizens and in direct contact with them. The three-member Board and its small staff were totally inadequate -- and probably unwilling -- to police 56 county assessors. The Board limited itself to hearing individual taxpayers' appeals from county equalization boards and lowering the assessment of whole classes of property when one county varied too markedly from others. (Teresa Olcott Cohea, "Property Tax Assessment: A Century-Long Struggle for Structured Discretion", Montana Public Affairs Report, Number 26, September 1978, p. 3.)

Statistics reported by various U.S. government agencies showed that actual assessments in Montana were falling further and further away from the mandated full cash value during the period from 1930 to late 1950. While sharply declining land prices coincided during the mid 1930s with declining assessments, by the late 1930s a pattern emerged that witnessed continuingly larger disparity between full

cash values and assessments. The State Board of Equalization ascribed this pattern to assessors' "precautionary regard for inflation tendencies." (Cohea, p. 3; Legislative Council Report, 1960, passim 20-23; Fourteenth Biennial Report of the State Board of Equalization, 1950, p. 3.) The charts presented in Appendix C demonstrate this pattern.

The situation became serious enough by 1954 that the State Board warned the Legislature:

> The fundamentals of our property tax system are set out in three sections of the Code: Section 84-401 provides for the assessment of all property at full cash value, and Sections 84-301 and 84-302 comprise the classification law. No other state has laws that are better, or as well designed to promote an ideal property tax system. Why haven't we got it? The classification law is not to blame . . . the principle back of it [of "proportional" contributions from taxpayers] has never been seriously questioned; but it is necessarily anchored in the full cash value provision of Section 84-401, and when we deliberately cut loose from that anchor we began to drift. The administration of the law has so deteriorated over the years that we now have a situation where assessments are made upon various percentages of full value, resulting in a classification law within a classification law. (Sixteenth Biennial Report of the State Board of Equalization (1954), p. 15.)

The Board thought that the remedy to this problem was simple: the state could either (1) enforce the law that mandated full cash value; (2) repeal the law; or (3) "adopt a middle of the road policy" which would withdraw the state from property tax receipts altogether. The Board's report indicated that it believed the third alternative might be the best.

The State Board of Equalization also warned county assessors of the discrepancies in levels of assessment between counties and proposed that all counties begin reassessing

local property at "'full cash value' or some standard percentage of it." The Chairman of the State Board was reported as warning assessors that if they did not begin such a program that the State Board would consider lowering valuations of statewide utilities and railroads to the average level of assessment in each county (which actually happened in 1959) and/or requesting legislation to reduce state payments to counties based on their assessment ratios. ("Brief of Montana County Commissioners' Association", before the House Special Committee on Taxation, Montana State Archives, RS 14, Box 2, Folder 25.)

Perhaps partly in response to the warnings of the Board and perhaps because of growing pressures for equalization caused by the 1949 School Equalization Program, the 1955 and 1957 Legislatures passed a Reclassification and Reappraisal Act to bring all real property assessments statewide up to their full cash value. (Chapter 198, Laws of 1955; Chapter 191, Laws of 1957.) Reclassification and reappraisal were to be completed in 5 years. But in September 1962 controversy broke out between the State Board and 26 county assessors who refused to accept values set by the Board on several classes of rural land.

The controversy spilled into the Legislature during the 1963 Session. The House created a special committee (the Senate declined to form such a committee) to deal with the problems of reappraisal and reassessment. The Special Committee on Classification and Appraisal noted that:

> Montana has a bear by the tail. Having undertaken the first stage of a program to bring about uniformity and equalization in the assessment of properties for taxation, the state now must proceed to complete the program . . . . [W]hile the poor wretch holding the bear's tail is in a perilous predicament, his salvation depends on tightening his grasp, not letting go. (Report of the Special Committee on Classification and

Appraisal to the House of Representatives of the Thirty-Eighth Legislative Assembly, February 5, 1963.)

The Special Committee urged the Legislature to continue support for reappraisal and to pass a bill that would control the growing practice of fractional assessments by legalizing their use. The bill died in committee.

But one bill of the Special Committee did pass the Legislature -- HJR 16. This resolution called for a study of the Montana property classification laws "to determine whether Montana's law is equitable, and if so, whether its administration is in fact resulting in equitable taxation".

Some of the major conclusions that resulted from the HJR 16 study were:

1) The 1919 classification law was, in part, a legalization of the existing extra legal classification accomplished by fractional assessments, an attempt to distinguish between income and non-income producing property, an attempt to increase tax collections on intangible personal property, and an attempt to tax the mining industry more heavily. (p. x.)

2) The law did not increase tax collections on intangible personal property, and the total impact of the classification law on the tax burden seems to have been slight. (p. x.)

3) . . . the contention that net proceeds are overvalued and overtaxed has not been proved. (p. xi.)

4) Until some common concept of value is applied to all property within the state, it will not be possible to measure accurately the degree of discrimination effected by tax laws and administrative procedures. (p. xiii.)

5) It is estimated that less than four percent of moneys and credits are taxed. The low rate of taxation, intended to encourage reporting, has apparently failed. (p. xiv.)

> 6) As a result of the long, fixed terms of Board members, the people of the state have no effective voice in establishing tax policy. As a matter of practice the Board has become a closed corporation and not even the chief executive can effectively influence administration of tax policy. (p. 33.)

The 1964 study made several recommendations. Mandatory sales ratio studies were suggested, as were two constitutional amendments that would allow the Legislature to eventually exempt household goods and furniture, wearing apparel, and similar personal property, and to exempt money and credits. The rationale for doing so tended to be that these types of assets were too difficult and expensive to discover and tax. (Report of the Special Committee, p. 35 - 40.)

Because of the fourth conclusion relating to the "common concept of value", the Committee reserved judgment about the equity questions.

The 1964 report's characterization that the State Board of Equalization was a "closed corporation" was perhaps the most forceful finding stated in the report. The Supreme Court added an addendum to the statement in 1965 and included the Legislature along with the chief executive as an institution that was not able to influence tax policy. The Court declared that the

> . . . State Board of Equalization had the constitutional authority to compel fractional assessment of property and that legislative control over the Board and assessment procedures was "directory" only. The court based its decision on the belief that the legislature and the court had left the fractional assessment rates used by the county assessors and the Board unchallenged for so long that the practice had become acceptable. (Cohea, p. 4.)

This decision must have confirmed earlier fears that tax policy was getting out of control.

Delegates to the 1972 Montana Constitutional Convention confronted these tax issues in their Committee on Revenue and Finance. The Committee met the issues head on and declared in its report:

> The details of any tax administration system should be left to the legislature, which is the best qualified to develop the most efficient, modern and fair system necessary for the needs of the day. Tax administration should be established by the legislature and administered by the executive branch of government, not by a constitutional board which is immune from control by the people. A constitutionally enshrined board is less answerable for its activities and is freer to ignore the mandates and directives of the legislative assembly. (Quoted in Cohea, p. 4.)

The Constitution approved by the people implemented these ideas. The Constitution referred to the "state" having responsibility for appraising, assessing, and equalizing values of property, not a specific board. The 1973 Legislature moved to make assessors "agents of the department of revenue" and to put that department in charge of assessing property and equalizing values.

For a time it appeared that the Legislature was in a position to control the broad outlines of property taxation policy. According to one close observer of both the legislative process and Montana property tax policy:

> The 1973 legislature did not . . . rise to the challenge. Fearing to do "too much too fast," the legislature gave the Department of Revenue the power in statute which the former State Board of Equalization had by constitutional amendment . . . . This was the section upon which the Supreme Court based its argument that the Board had the power to establish fractional assessments. A bill to require that "all taxable property must be

assessed at its full cash value and not any percentage thereof" did not get out of committee.

The Department of Revenue was, understandably, reluctant to take the giant step of raising all assessments to full cash value without a clear legislative mandate. The passage of the 1973 act seemed to be a mandate for quite the opposite -- continued fractional assessment. In late 1972 and early 1973, the Department promulgated over 50 pages of rules in the newly-established Montana Administrative Code, containing the written and unwritten rules the Board of Equalization had used. These rules were all based on a fractional assessment of full cash value.

The legislature itself adopted some of the Board's rules of fractional assessment, enacting them into statute. The 1973 session amended 84-401 to read "All taxable property must be assessed at its full cash value except the assessment of agricultural land shall be based upon the productive capacity of the land when valued for agricultural purposes . . . ." Supporters argued that the reduced tax rate the Board had granted agricultural land might help conserve it. Two years later, the legislature further amended the section by enacting the Board's 40% rule: "All taxable real property must be assessed at 20% of its full cash value . . . ." (Cohea, p. 5.)

The amendments were apparently designed, in part, to insure that the Legislature controlled both tax assessment standards and rates. While the amendments did not treat all property in the same manner (personal property was not addressed), the one sure thing that the amendments did was to legalize fractional assessments; 1973 was the first time that the Legislature had explicitly done so.

The "legalized" fractional assessments, however, were but a fraction of the de facto ones that existed through various rules of the Department of Revenue. The 1975 Legislature asked that a study be conducted to examine "the tax classification system presently used by the department of revenue, including administrative rulings, for the purpose of

determining whether or not the existing classifications are equitable."

The interim Subcommittee on Taxation conducted a preliminary examination of the tax system and concluded that a necessary first step before the issue of "equity" could be determined would be to discover the level of fractional assessments used by the Department of Revenue for the various kinds of property in Montana. During the interim study the subcommittee found that:

> Although recent legislatures have changed many aspects of Montana's property tax system, the legacy of seventy-five years of fractional assessment remains today. Upon its creation in 1973, the Department of Revenue adopted the rules of the State Board of Equalization and the practices established by county assessors. At present [December, 1976], all property is assessed by Department of Revenue regulations at values ranging from 25% to 100% of full cash value . . . . These varying percentages, applied against different types of property within each class, have obscured the statutory 11-step classification system and created 22 different rates of taxation . . . . This de facto 22-step classification system . . . bears little resemblance to the statutory 11-step system. Some property within the same class, which is supposed to be taxed at the same rate, is taxed at rates 54% higher than other property in the same class. Property in different classes, on the other hand, is sometimes taxed at the same rate, although . . . [statute] requires its taxation at markedly different rates. (Subcommittee on Taxation, Montana's Property Taxes: Assessment and Classification, Montana Legislative Council: December 1976, pp. 9-10.)

The Subcommittee concluded that the Legislature should be the body which established the effective tax rates. In orderto streamline the classification system and to require that most property be assessed at 100% of "market value" and taxed at rates set by the Legislature, the Subcommittee introduced two bills into the 1977 Session: House Bill 45 and House Bill 70 (Chapter 566, Laws of 1977). Only House

Bill 70, which required property be assessed at 100% of market value and taxed at rates established by the Legislature, passed the Legislature. The other measure was held for further study.

With the passage of House Bill 70 and other measures during the 1977 Session, Montana's classified property tax consisted of 20 classes of property with similar kinds of property scattered throughout the classes and taxed at different rates. The 1977 Legislature called for further work during the 1977-79 interim. House Joint Resolution 98 asked for a study of the "property tax classification system as a whole, with special emphasis on the reasons for classing certain property together and the equity of taxing each type of property at its current rate." The Revenue Oversight Committee appointed a subcommittee to undertake the study.

The Subcommittee recommended the introduction of a bill to reduce the number of property tax classes from 20 to 10, the rounding of tax rate in each class to make calculations less complex, the grouping of like property in the same class, and the elimination of rarely used tax classifications. (Revision of Montana's Property Tax Classification System, Revenue Oversight Committee: December 1978, p. 4.)

The Revenue Oversight Committee's report on the study stated that the bill which the Committee introduced into the 1979 Session (House Bill 213 (Chapter 693, Laws of 1979)) was a "significant achievement" because the proposed legislation:

1) makes property taxation easier for citizens to understand;

2) decreases the complexity of the assessor's work;

3) makes tax rates more equitable by grouping property of a like nature together;

4) achieves these objectives without significant fiscal impact. (p. 5.)

House Bill 213 passed the Legislature and was signed by the Governor.

Since 1979, there have been no major revisions of the property tax classification system. There have been several trends in recent years that affect the classification system. Removal of property from the classification system and imposition of fees in lieu of property taxes has been a trend in the last few legislative sessions. These changes have involved movable personal property such as travel trailers, snowmobiles, and cars and light trucks.

Exemptions and partial exemptions have also played a part in recent legislative changes to the property tax system. Senior citizens have received increased exemptions for portions of the assessed value of their homes, and business inventories have been eliminated.

A third trend has been to shift at least part of the fiscal effects of property tax exemptions or reductions from local governments to the state, usually to the state individual and corporate income tax or to state severance taxes. Examples of this include property tax relief for senior citizens, the business inventory tax, and the car and light truck fee system.

CONCLUSION

Almost a century has passed since Montana became a state. The years have been filled with changes to the taxation system and shifting administrative practices. One thing has remained fairly constant, however. Arguments about taxation policy have always revolved around the issues of how to

define "property", how to assess it "equitably", how to create an efficient administrative system to collect taxes, and how to control these varied elements in a way that arrives at "fair" taxation based on ability to pay.

Several patterns can be observed. Governor Stewart, speaking to the 1915 Legislature, noted that "no great emergency confronts the State or its people . . . ." He believed that the 1915 Legislature could "well afford to 'stand by'" on most of the important issues of the day. While many Montana Legislatures have been content to "stand by" to see what developed, or to give laws and officials a chance to work, in the long run the Legislature also has been willing to make substantial changes to tax structures, usually at the state level, to arrive at some idea of equity, and to insure that the Legislature itself controlled tax policy. Much, if not all, of the major property tax classification legislation passed in Montana seems to have had these two goals in mind.

Another pattern in the history of property tax administration has been an attempt by the Legislature to maintain "full cash value" (after 1977 "market value") as the assessment standard against which the state and local tax rates applied. Quite as constant was the inability to achieve that standard.

The lack of a common concept of value actually applied to all property by state and local officials was (and is) probably the single most important reason that no committee, legislative or otherwise, has been able to meaningfully assess the equity of the property tax classification system. The historical inability to actually use a common concept of value was due to many factors: the general complexity of economic theories relating to property taxation, the desire by both state and local officials not to be blamed for tax

increases, the restraints of the 1889 Constitution relating to mineral properties, and the shifting popular notions of what was fair. Regardless of the complexities, the demand for a common concept of value was made many times in the past. The Lewis and Clark County Assessor, Mr. Martien, put the issue this way in 1918:

> The Special Tax Committee appointed at the last session of the Legislature got out a report showing the total taxes paid on several classes of property with the relative percentage of that particular class to the total taxes paid in the State. I cannot see where this can be of any value whatever in trying to take these figures to arrive as to whether or not each class or interest is paying its just proportion of the tax burden. What the taxpayers want to know is what percentage of the actual value of each class or interest is assessed, and which is the only way to determine who is being stung. (Farmers Tax Conference, Lewistown, Montana, February 12-14, 1918, presentation by Mr. Martien, p. 37, Montana Historical Society, SC 243.)

Seen in this light, the Legislature's historical insistence on assessing property at 100% of value was because total value was essential to ensuring that the Legislature understood and controlled the effects of state taxation policy and its philosophical standards of equity.

One critic of the classification system in Montana commented in 1944:

> The legislature, the tax and license commission, and the two major parties indicated in 1919 that political pressures were now apparently deadlocked. The state legislature had avoided direct action by appointing the commission. Both the Democrats and the Republicans had urged a more equitable distribution of the tax burden, and each had called attention to the tax and license commission, suggesting that in the final report of this body would come the answer to the problem. But the tax and license commission had refused to take the responsibility so willingly thrust upon

it, and had recommended on the legalization of the system then actually in operation. (Warren Aldrich Roberts, "State Taxation of Metallic Deposits" (Montana Historical Society; RS 1, Box 3, File 143.)

Mr. Roberts seems to have been only partly right. The Commission expressed several times its assurances that the classification plan would not radically change the status quo. This they admitted. Their goal, it seems, was not to reform the entire property tax system but to standardize and bring under legislative control that part of the system that was within the Legislature's discretion to change. In recommending changes, the Commission attempted to adjust the general property tax system to human tendencies to hide property. The classification system suggested by the Commission and adopted by the Legislature was designed to standardize the tax system and to encourage property owners to be honest about their wealth and subject a part of it to taxation.

The classification system itself seems to have been, among other things, an attempt to encourage people (both citizens and tax assessors) to report the true value of all taxable property. It was assumed that when all property was reported the largest degree of equity possible would return to the property tax system.

APPENDIX A

A comparison of the tax rates in Montana prior to classification (effected through fractional assessments), the rates set by the property classification law, and comparable rates in Minnesota and North Dakota at about that time is shown in the table below.

COMPARISON OF TAX RATES FOR VARIOUS TYPES OF PROPERTY IN MONTANA, MINNESOTA, AND NORTH DAKOTA

	RATES (percentage relationship to full value)			
Property	Montana 1918 a	Montana 1919 b	Minnesota c	North Dakota d
1. Mines, net proceeds	100	100	50e	None
2. Land	30	30	33 1/3 - 40	30
3. Livestock	18 - 52	33 1/3	33 1/3	20
4. Household goods	Various	20	10	20
5. Tools and Machinery	Various	20	10	20
6. Stocks of merchandise, store fixtures, etc.	Various	33 1/3	33 1/3	20
7. Moneys and credits	Unknown	7	f	5
8. Bank stock	65	40	40	20

a. *Report*, p. 10.
b. Taxable rates recommended by the Tax and License Commission and contained in the 1919 property classification law.
c. Rates shown are for 1926, *Classified Property Tax*, p. 228-29.
d. *Ibid.*, p. 243.
e. In Minnesota, mined and unmined ore, rather than net proceeds.
f. Flat rate of three mills on the dollar of valuation.

Some of the similarities in the Montana classification law and those of Minnesota and North Dakota are striking; however, neither system was adopted in total.

Source: Property Taxation and the Montana Property Classification Law, (Montana Legislative Council: December 1964), p. 12.

APPENDIX B

Since 1919 the classification law has been subjected to the following amendments:

1921: --To net proceeds of mines in class one was added the right to enter upon land to explore or prospect or dig for oil, gas, coal or mineral where the surface title to the land has passed to another.

1929: --Moneyed capital and shares of both national and state banks were made taxable at 30%.

1937: --"All office and hotel furniture and fixtures" were placed in class three (33 1/3%).
--Added to class five (7%) were "all poles, lines, and other property used and owned by cooperative rural electrical association organized under the laws of Montana".

1941: --The property of cooperative rural electrical associations in class five was explicitly declared to include "transformers, transformer stations, meters, tools, improvements, machinery".

1947: --Grains, hay, and vegetables on the farm or in storage awaiting processing were explicitly excluded from class three (33 1/3%) and placed in class five (7%).
--The inclusion of office and hotel furniture in class three was changed to office "or" hotel furniture.

1951: --Unprocessed products of livestock and poultry were explicitly included in class three.
--The inclusion of grain, hay, and vegetables in class five was changed go "All unprocessed agricultural products either on the farm or in storage irrespective of whether said products are owned by the elevator, warehouse or flour mill owner or company storing the same, or by any other person whomsoever, and excepting livestock and poultry and unprocessed products of both."
--Industrial property, normally included in class four, was placed in class five

for a period of three years after such property is first assessed.

1957: --Cooperative rural telephone associations were included in class five.
--The provision for inclusion of new industrial property in class five for three years was deleted.
--Bank surplus up to the amount of stated capital was changed to 7%.
--Moneyed capital and shares of banks and surplus in excess of stated capital were retained at 30%.

1961 --Class 4 was amended to include " and all trailers affixed to land owned, leased, or under contract of purchase by the trailer owner".
--An additional class called new industrial property was added at a tax rate of 7% of true and full value and former Class 7 was redesignated Class 8.

1965 --An additional class was created for improvements to real property valued at not more than $15,000 and owned and actually occupied by a widow, widower or a receipient of retirement benefits not exceeding $150 per month ($250 if married). The taxable rate for this class was set at 20% of true and full value.
--Exempted irrigation and drainage facilities.

1967 --Placed freeport merchandise in class seven at 7%.
--Clarified the definition of mobile homes and placed them in class 4.

1969 --Included telephone companies serving rural areas and cities and towns with 800 or less inhabitants and with average circuit miles for each station of more than one and one-quarter mile in class 2.
--Increased the valuation and income limits on owner-occupier real property in class 8 to $17,500 valuation and $3,300 income ($4,500 if married) per year. The tax rate on class 8 property was reduced from 20% to 15%.

1971 --Freeport merchandise was made a separate class and the tax rate was reduced to 1%.
--Added mobile homes to class 8 (tax reduction for certain widows, widowers, retirees) and increased the income limitations to $4,000 ($5,200 if married).
--The residence of a totally disabled veteran was placed in class 5 at 7% of true and full value.
--Moved the equipment of co-operative rural electrical and telephone companies serving less than 95% of the population within an incorporated city or town from 7% of true and full value to 20%.

1973 --Freeport merchandise was exempted from property taxation.
--Unprocessed, perishable fruits and vegetable in farm storage and owned by the producer were removed from class 5 (7%) and exempted from property taxation.

1974 --Household goods and personal property used for personal or domestic purposes was exempted from property taxation.

1975 --Business inventories were removed from class 3 (33 1/3%) and placed in class 7 (7%).
--Money and credits (7%) were exempted from property taxation. This did not apply to banks.
--Placed centrally assessed utility allocations, after deduction of locally assessed property, in class 9 (40%).
--Revised the valuation and income limitations for certain widows, widowers, and retirees (Class 8 [15%]). Valuation limit was increased to $27,500 and income limit became $6,000 ($6,800 if married). The size of the lot appurtenant to the dwelling was allowed to be up to 5 acres. The assessed value of such a residence was frozen during the life of the person who qualified for this class unless such person made a 'substantial' improvement in the dwelling.
--Created a new class for the incremental increase in the value of

real estate attributable to repairing, maintaining or improving existing improvements. The tax rate on the increment began in the first year following completion of the repair at 6% and increased each year until it reached 30%.
--Excluded from class 7 (7%) any new industrial plant which would create an 'adverse' impact upon existing state, county, or municipal services.
--Removed coal mines from class 1 (100%). Placed the annual gross proceeds of underground coal mines in class 3 (33 1/3%) and the annual gross proceeds of coal mines using a strip mining method in a new class 9 (45%).
--Included certain capital investments in recognized nonfossil forms of energy generation in class 7 (7%) and certain capital investments in a building for an energy conservation purpose in class 8 (15%).

1977 --Generally revised and recodified sections relating to classifications and revised percentages applicable to several classes due to statewide reappraisal.
--Established market value as basis of taxation, except for certain cases.
--Removed livestock, poultry and the unprocessed products of both from class 3 (33 1/3%) and placed them in class 2 (20%).
--Removed metal mines from class 1 (100% of net proceeds) and placed in a separate class at 7.5%.
--Revised the valuation and income limits of property owned and occupied by certain widows, widowers and retirees. The valuation limit was raised to $35,000 and the income limits were increased to $7,000 ($8,000 if married). Deleted the prohibition against reappraising this class of property during the occupancy of the dwelling of a qualified taxpayer.
--Created a class for pickup campers, travel trailers and motor homes owned and actually used by certain senior citizens and applied a taxable rate of 10%.
--Transferred the alternative energy

and energy conservation property tax incentives created in 1975 to the state income and corporation license tax system and made such capital investments deductable.
--Exempted from taxation the real estate and improvements of certain community service organizations.
--Exempted certain toppers and truck canopy covers from property taxation.
--Exempted swine that had not attained the age of 3 months as of January 1.

1979 --Generally reorganized property tax classes and adjusted percentages applicable to certain classes to maintain status quo.
--Reduced temporarily the taxable value of certain golf courses, including land and improvements, to one-half the taxable rate applicable to other land and improvements.
--Reduced the taxable percentage applicable to personal and real property used primarily in the production of gasohol during construction and for the first three years of its operation.
--Required that all operating property owned by centrally assessed companies be assessed by the Department of Revenue and to apply a single property tax rate to that property.
--Exempted antique aircraft.
--Provided a fee in lieu of property tax for motor homes, travel trailers, snowmobiles, and campers.
--Exempted mopeds from property taxation.
--Exempted sprinkler irrigation systems from property taxes.

1981 --Provided for a graduated schedule, if local government approved, of a 5 year temporarily reduced tax rate applicable to improvements on existing real property and for new construction or expansion of existing manufacturing industries.
--Increased the income limits for certain widows, widowers, and retirees to $8,000 ($10,000 if married) and provided a sliding scale to determine the taxable percentage applicable to such property.

--Reduced the taxable percentage applicable to livestock, poultry, and the unprocessed products of both from 8% of market value to 4%.
--Business inventories exempted from taxation.
--Reduced from 1½ to 1 mile the mileage limitation between stations on telephone communications equipment that qualified for the 8% taxable rate as opposed to a 15% rate.
--Exempted automobiles and light trucks from property taxation and provided for a fee in lieu of property taxes.
--Permitted the department of revenue to modify the percentage multiplier used in converting the market value of railroad property to taxable value to achieve compliance with the federal 4-R Act.
--Included the allocations of properties constructed, owned or operated by public agencies created by congress to transmit or distribute electric energy at privately owned generating facilities within the class of property taxable at 12%.

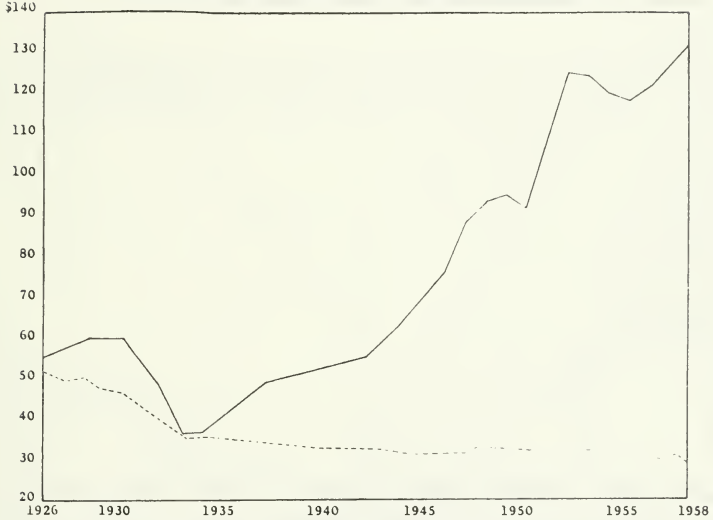
1983 --Exempted the right of entry reserved in land that is held to explore, prospect, or dig for oil, gas, coal, or minerals.
--Made the tax reduction for certain golf courses permanent.
--Created a new class for trailers and mobile homes, regardless of size, when used as residences.
--Clarified the status of goods and equipment intended for rent or lease as taxable at either 11% or 4%.
--Provided that trailers 18,000 lbs. or under are taxable at 11% of market value and those over 18,000 lbs. are taxable at 16% of market value.
--Exempted real estate and improvements of certain water associations.

APPENDIX C

The following charts present historical and current tax data relating to state and local taxation in the United States, the West, and Montana.

Graph I

Average Market Value Per Acre and Average Assessed Value Per Acre for Irrigated Farm Land in Montana, 1926-1958



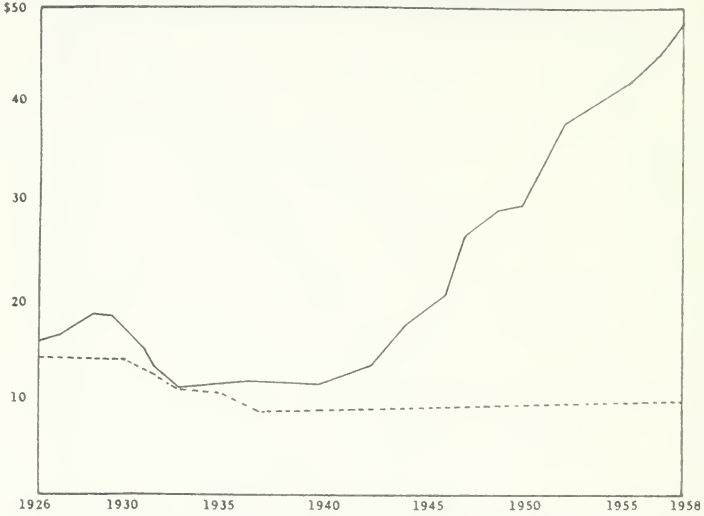
Source: Average market values per acre are from the Agricultural Research Service, U. S. Dept. of Agriculture. The average assessed values per acre are from the Biennial Reports of the State Board of Equalization.

Key:
Average Assessed Value Per Acre. - - - - - - - - -
Average Market Value Per Acre. ————————————

Source: Property Taxation in Montana (Montana Legislative Council: December, 1960), p. 21.

Graph II

Average Market Value Per Acre and Average Assessed Value Per Acre for Non-Irrigated Farm Land in Montana, 1926-1958



Source: Average market values per acre are from the Agricultural Research Service, U. S. Dept. of Agriculture. The average assessed values per acre are from the Biennial Reports of the State Board of Equalization.

Key:

Average Assessed Value Per Acre. - - - - - - - - -

Average Market Value Per Acre. ————————————

Source: Property Taxation in Montana, (Montana Legislative Council: December 1960), p. 22.

Graph III

Average Market Value Per Acre and Average Assessed Value Per Acre for Grazing Land in Montana, 1926-1958

Source: Average market values per acre are from the Agricultural Research Service, U. S. Dept. of Agriculture. The average assessed values per acre are from the Biennial Reports of the State Board of Equalization.

Key:

Average Assessed Value Per Acre. - - - - - - - - -

Average Market Value Per Acre. ————————————

Source: Property Taxation in Montana, (Montana Legislative Council: December, 1960), p. 23.

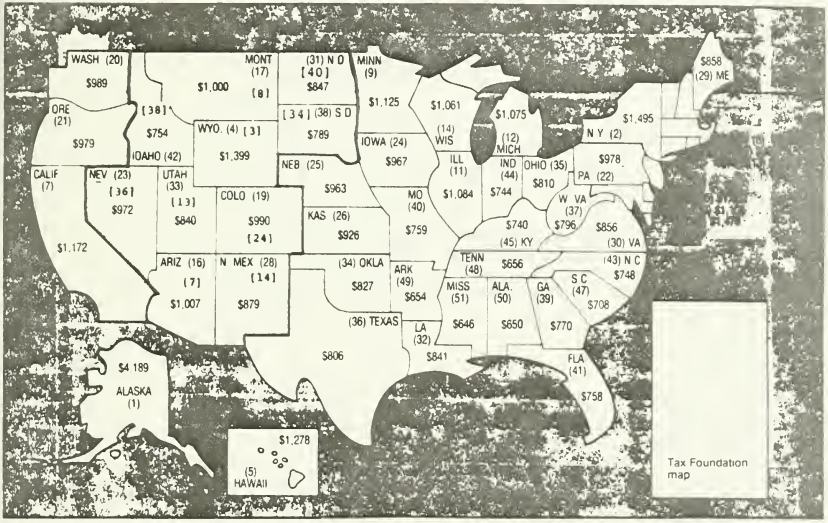
STATE PERSONAL INCOME: 1929 - 1980 (Actual Dollars)

	Ariz.	Colo.	Idaho	Mont.	Neva.	NMex.	NDak.	SDak.	Utah	Wyom.
PER CAPITA 1980* (dollars)	8,649 (4)	9,964 (3)	8,126 (7)	8,445 (6)	10,458 (2)	7,956 (8)	8,556 (5)	7,452 (10)	7,485 (9)	10,692 (1)
1970	3,631 (4)	3,839 (2)	3,280 (6)	3,498 (5)	4,452 (1)	3,117 (10)	3,120 (9)	3,124 (8)	3,228 (7)	3,796 (3)
1960	2,030 (5)	2,271 (2)	1,846 (8)	2,036 (4)	2,848 (1)	1,886 (7)	1,714 (10)	1,783 (9)	1,971 (6)	2,267 (3)
1950	1,330 (5)	1,487 (4)	1,295 (7)	1,622 (3)	2,018 (1)	1,177 (10)	1,263 (8)	1,242 (9)	1,309 (6)	1,668 (2)
1940	502 (5)	544 (4)	450 (7)	566 (3)	890 (1)	373 (8)	340 (10)	360 (9)	482 (6)	606 (2)
1929	593 (5)	644 (3)	502 (7)	601 (4)	896 (1)	381 (9)	365 (10)	417 (8)	558 (6)	683 (2)

* Preliminary

Note: Number in parenthesis indicates standing of state among all 10 states
Sources: Historical Statistics of U.S.: Colonial Times to Present, Part I, USDC, B of C., 1975; Survey of Current Business, April 1981

PER CAPITA STATE AND LOCAL TAXES: 50 STATES
& 10 STATE RANKING FOR STATE AND LOCAL
TAXES PER $1,000 OF PERSONAL INCOME



Number in parentheses indicates standing of states (1 being highest) according to burden of state and local per capita tax.
Dollars equal per capita tax in Fiscal 1980.
Number in brackets indicates standing of states (1 being highest) according to burden of state and local taxes per $1,000 of personal income.

STATE AND LOCAL TAXATION IN NEIGHBORING STATES: 1979-80 (Actual Dollars)

(In Millions)	TAXES Total	Property	%	Gen. Sales	%	Income	%	Other	%
Arizona									
State	$ 1,684.4	$ 122.0	7	$ 814.6	48	$ 405.3	24	$ 342.6	20
Local	1,053.8	834.0	79	162.4	15	0.0	0	57.4	5
Total	2,738.2	956.0	35	976.9	36	405.3	15	400.0	15
Colorado									
State	1,490.9	3.7	*	537.4	36	571.9	38	377.9	25
Local	1,368.3	947.9	69	336.3	25	0.0	0	84.1	6
Total	2,859.2	951.6	33	873.6	31	571.9	20	462.1	16
Idaho									
State	490.3	.2	*	137.1	28	201.7	41	151.3	31
Local	221.7	213.7	96	0.0	0	0.0	0	8.0	4
Total	712.0	213.8	30	137.1	19	201.7	28	159.4	22
Montana									
State	435.8	18.1	4	0.0	0	180.6	41	237.1	54
Local	351.0	340.2	97	0.0	0	0.0	0	10.8	3
Total	786.8	358.3	46	0.0	0	180.6	23	247.9	32
Nevada									
State	476.6	21.0	4	182.9	38	0.0	0	272.7	6
Local	300.2	183.4	61	28.9	10	0.0	0	87.8	29
Total	776.8	204.5	26	211.8	27	0.0	0	360.6	46

(In Millions)	Total	Property	%	Gen. Sales	%	Income	%	Other	%
New Mexico									
State	926.0	24.3	3	402.9	44	93.1	10	405.7	44
Local	217.0	160.5	74	28.4	13	0.0	0	28.1	13
Total	1,143.0	184.8	16	431.3	38	93.1	8	433.8	38
North Dakota									
State	371.9	2.2	1	124.0	33	89.7	24	156.0	42
Local	181.1	173.4	96	0.0	0	0.0	0	6.7	
Total	553.0	175.6	32	124.0	22	89.7	16	163.7	30
South Dakota									
State	270.5	0.0	0	147.2	54	3.3	1	120.0	44
Local	273.6	242.0	89	19.0	7	0.0	0	12.6	5
Total	544.1	242.0	45	166.2	31	3.3	1	132.6	24
Utah									
State	785.8	.1	*	324.7	41	305.7	39	155.3	20
Local	441.1	342.6	78	70.7	16	0.0	0	27.8	6
Total	1,226.8	342.8	28	395.5	32	305.7	25	182.8	15
Wyoming									
State	388.1	23.1	6	163.1	42	0.0	0	201.9	52
Local	271.0	236.8	87	28.5	11	0.0	0	5.7	2
Total	659.1	259.8	39	191.6	29	0.0	0	207.7	32
United States									
States Government	137,075.2	2,892.1	2	43,167.5	32	50,410.8	37	40,604.8	30
Local Government	86,387.5	65,606.6	76	8,160.1	9	4,990.3	6	7,630.5	9
All Governments	$223,462.6	$68,498.7	31	$51,327.6	23	$55,401.1	25	$48,235.2	22

*Less than 0.5%
Source: GF80-#5, Gov't Finances in 1979-1980, U.S. Dept. of Commerce.
Population: PHC 80-V-1
Note: Due to rounding, numbers do not always add to totals and percentages do not always add to 100.

PER CAPITA STATE & LOCAL TAXATION IN NEIGHBORING STATES: [illegible] (Actual Dollars)

(In Dollars)	Total Taxes	Property	General Sales	Income	Other
Arizona					
State	$ 619.75	$ 44.89	$299.72	$149.12	$126.13
Local	387.73	306.86	59.75	0.00	21.12
Total	1,007.48	351.75	359.44	149.12	147.25
Colorado					
State	516.09	1.28	186.03	197.97	130.81
Local	473.65	328.13	116.41	0.00	29.11
Total	989.74	329.41	302.44	197.97	159.92
Idaho					
State	519.42	.21	145.24	213.68	160.29
Local	234.87	226.39	0.00	0.00	8.48
Total	754.29	226.60	145.24	213.68	168.77
Montana					
State	553.97	23.01	0.00	229.57	301.39
Local	446.17	432.44	0.00	0.00	13.73
Total	1,000.14	455.45	0.00	229.57	315.11
Nevada					
State	596.36	26.28	228.86	0.00	341.22
Local	375.63	229.48	36.16	0.00	109.86
Total	971.99	255.89	265.02	0.00	451.21
New Mexico					
State	712.33	18.69	309.93	71.62	312.[illegible]
Local	166.93	123.46	21.85	0.00	21.62
Total	879.25	142.16	331.78	71.62	333.70

(In Dollars)	Total Taxes	Property	General Sales	Income	Other
North Dakota					
State	569.79	3.37	189.98	137.43	239.01
Local	277.46	265.67	0.00	0.00	11.80
Total	847.25	269.04	189.98	137.43	250.81
South Dakota					
State	391.93	0.00	213.28	4.78	173.87
Local	396.42	350.63	27.53	0.00	18.26
Total	788.35	350.63	240.81	4.78	192.13
Utah					
State	537.84	.07	222.24	209.23	106.29
Local	301.91	234.49	48.39	0.00	19.03
Total	839.75	234.56	270.63	209.03	125.32
Wyoming					
State	824.31	49.06	346.42	0.00	428.83
Local	575.60	502.96	60.53	0.00	12.11
Total	1,399.91	552.02	406.95	0.00	440.94
United States					
State Governments	605.18	12.77	190.58	222.56	179.27
Local Governments	381.39	289.64	36.03	22.03	33.69
All Governments	986.57	302.41	226.61	244.59	212.96

Source: GF 80-#5, Government Finances in 1979-1980, USD of C;
Population: PHC 80-V-1.
Note: Due to rounding, numbers do not always add to totals and percentages do not always add to 100.

TAXES PER $1,000 OF PERSONAL INCOME: 1979-80 (Actual Dollars)

(In Dollars)	Total Taxes	Total State Taxes	Total Local Taxes	Local Property Taxes
Arizona	$123.54	$72.27	$45.21	$35.78
Colorado	105.88	55.21	50.67	35.10
Idaho	97.90	67.43	30.48	29.38
Montana	125.13	69.31	55.82	55.10
Nevada	98.55	60.47	38.09	23.27
New Mexico	116.59	94.45	22.13	16.37
North Dakota	104.28	70.13	34.15	32.70
South Dakota	108.99	54.19	54.81	48.48
Utah	117.92	75.53	42.40	32.93
Wyoming	141.56	83.35	58.20	50.86
Regional Average	114.03	70.23	43.20	36.00
United States	110.18	67.59	42.60	32.35

Sources: GF 80 #5, Government Finances in 1979-80; Survey of Current Business, USDC, Bureau of Economic Analysis, Total Personal Income, April 1981, Vol. 61, #4, p. 38.

PERCENT OF TOTAL LOCAL GOVERNMENT GENERAL REVENUE
FROM OWN SOURCES BY MAJOR SOURCE

	1980			1957		
	Property Taxes	Nonproperty Taxes	Charges & Misc. Revenue	Property Taxes	Nonproperty Taxes	Charges & Misc. Revenue
Montana	69%	2%	29%	80%	6%	14%
Arizona	54	14	32	69	6	25
Colorado	46	21	33	74	7	19
Idaho	56	2	42	75	3	22
Nevada	33	21	46	55	15	30
New Mexico	39	14	48	48	15	37
North Dakota	56	2	41	81	3	17
South Dakota	68	9	23	81	6	12
Utah	53	15	32	76	4	20
Wyoming	53	8	39	68	5	27
10 State Average	52.7	10.8	36.5	70.7	7	22.3
All States Average	50	16	34	69	11	20

SUMMARY OF PERCENT OF INCREASE (DECREASE) IN GENERAL REVENUE

1957 to 1979-80

	U.S.	10 State Region	Ariz.	Colo.	Idaho	Mont.	Neva.	NMex.	NDak.	SDak.	Utah	Wyom.
GENERAL REVENUE TOTAL	125%	97.9%	105%	93%	87%	105%	50%	118%	109%	91%	101%	135%
I. By Type of Revenue												
From Federal Government	385	182.1	196	158	192	234	79	99	279	229	251	104
From Own Sources	96	83.4	92	82	67	77	43	104	85	64	75	145
TAXES	74	59.1	85	56	44	59	25	73	44	39	51	116
Property	20	11.5	39	2	(14)	23	(9)	20	(13)	6	(4)	65
State	36	(53.8)	2	(99)	(99)	(8)	(7)	(27)	(77)	(100)	(99)	(24)
Local	19	18.0	47	10	(10)	25	(9)	33	(11)	7	1	85
Nonproperty	118	103.3	124	112	102	106	44	90	107	84	94	170
State	114	98.3	109	80	106	121	34	93	111	85	90	164
Sales & Gross Receipts	54	16.1	52	9	32	(49)	(33)	23	8	32	24	63
Income	344	290.3	236	256	188	360	--	249	443	403	182	--
All Other	90	247.9	294	126	34	280	53	268	253	54	128	432
Local	145	173.5	361	433	111	(44)	109	46	23	75	495	239
CHARGES & MISC. REVENUE												
State	275	175.5	97	184	206	152	57	197	193	188	267	214
Local	173	166.3	137	202	135	189	133	111	222	145	134	249
II. By Originating Level												
Federal	385	182.1	196	158	192	234	79	99	279	229	251	104
State	131	106.0	95	87	113	118	35	118	133	111	99	151
Local	63	69.1	188	76	22	45	53	64	29	29	46	139
III. By Final Recipient												
State	162	106.4	87	138	99	116	16	106	132	118	119	133
Local	106	91.7	118	73	77	95	82	99	85	67	85	136

PERCENT OF TOTAL GENERAL REVENUE
OF ALL GOVERNMENTS BY MAJOR SOURCE

1957 to FY 1980

	1980			1957		
	Federal	Taxes	Charges	Federal	Taxes	Charges
Montana	29%	52%	19%	18%	68%	14%
Arizona	18	63	19	13	70	17
Colorado	20	56	24	15	70	15
Idaho	25	53	22	16	68	16
Nevada	21	54	25	17	64	18
New Mexico	22	45	29	22	53	24
North Dakota	22	44	33	12	64	23
South Dakota	29	49	22	16	68	16
Utah	25	54	21	15	71	14
Wyoming	21	52	27	25	56	19
Average	23.2	52.2	24.1	16.9	65.2	17.6

THE TREND OF PROPERTY TAXES LEVIED IN MONTANA FOR PUBLIC SERVICES

	Taxable Valuation	State	County	Schools	Misc.	Towns & Cities	Total
1980-81	$1,845,008,980	$13,313,790	$86,169,668	$245,420,030	$20,711,755	$52,846,623	$418,461,866
	1,220	9	57	162	14	35	277
	959,567,796	6,924,348	44,815,846	127,640,114	10,771,944	27,484,916	217,637,168
1970-71	952,698,790	8,511,929	38,523,714	101,129,060	5,259,098	23,864,139	177,287,940
	1,497	13	61	159	8	38	279
	1,039,780,398	9,289,963	42,044,981	110,372,780	5,739,807	26,045,445	193,492,976
1960-61	691,646,680	5,851,235	25,073,390	45,980,658	3,299,611	13,932,315	94,137,209
	1,784	15	65	119	9	36	243
	1,203,910,670	10,184,917	43,643,847	80,035,958	5,743,448	24,251,201	163,859,371
1950-51	459,303,967	3,574,802	13,989,647	20,137,920	1,951,313	6,817,749	46,471,431
	1,905	15	58	84	8	28	193
	1,125,745,017	8,761,770	34,288,350	49,357,647	4,782,630	16,710,169	113,900,566
1940-41*	320,055,013	1,819,396	8,839,566	9,502,105	660,730	3,889,586	24,711,383
	2,777	16	77	82	6	34	214
	1,553,665,112	8,832,019	42,910,515	46,126,723	3,207,427	18,881,485	119,958,169
1930-31*	453,080,548	2,055,928	10,656,316	11,778,441	1,137,716	4,539,499	30,167,900
	3,902	18	92	101	10	39	260
	2,097,595,130	9,518,185	49,334,796	54,529,819	5,267,204	21,016,199	139,666,203

First figure represents actual dollars.
Second figure represents per capita dollars
Third figure represents constant 1972 dollars

*The implicit prices deflators for FY's 1931 and 1941 actually use calendar years 1930 and 1940

CHAPTER TWO

FEDERAL CONSTRAINTS ON STATE TAXATION OF RAILROAD PROPERTY

This chapter is a preliminary background report on the taxation of railroads in Montana. The chapter attempts to provide an introduction to what Montana's policy toward railroad taxation has been, how the policy has evolved, and what the constraints on that policy are, given federal legislation in the area. This is a survey document that is useful as background to the issue of railroad property taxation in Montana.

MONTANA'S RELATIONSHIP WITH RAILROADS

Transportation has been a critical issue in Montana from before territorial days to the present. The first Territorial Assembly of 1865 approved a total of 114 measures -- 30 of them dealing with improving transportation on Montana's mining frontier.

One of the transportation measures approved (unanimously in both houses of the Legislature) in 1865 granted a Territorial Charter to the Missouri River Portage and Railroad Company. The Legislature hoped to provide a route around the falls of the Missouri. Although the railroad was never constructed, the legislation is noteworthy because it began a tradition of legislative involvement between the state and railroads. This early legislation granted a private company the right to construct a railroad but reserved to the county commissioners of the affected counties the authority to establish passenger and freight rates upon the railroad. The bill for the Missouri River Portage and

Railroad Company wove the first threads of involvement between the state and railroads and also provided the first strings of legislative control over the railroad industry in the state.

From 1865 until the present, the Montana Legislature has been involved with railroads in five distinct areas. During the period the Legislature attempted to:

-- maintain competition and prevent monopoly;

-- prevent passenger and freight fare discrimination;

-- prevent passenger and freight service discrimination;

-- protect citizens (both railroad employees and others) from injury and death; and

-- generate revenue through taxation.

According to one informed observer, Rex Myers, an historian in the Montana University System, the 100-plus years of relationship between the state and railroads saw a "gradual deterioration of state powers in these five areas and the continual growth of federal influence. . . . By 1970, Montana had lost or had had seriously challenged her exercise of authority in all segments of railroad regulation." (Rex C. Myers, "Montana: A State And Its Relationship with Railroads, 1864-1970", unpublished doctoral dissertation, University of Montana, Missoula, Montana, 1972, p. 1-2.) Taxation policy, however, still remained an area of considerable state discretion. Historian Myers concluded his doctoral dissertation by noting:

> If the past provides any indication of the future, it will be only a matter of time until Montana yields control of railroad taxation and the vestiges of safety and service regulation. That will end the Montana/railroad relationship. (Myers, p. 220.)

Taxation: Territorial Period

Ten days after the creation of Montana Territory on June 22, 1864, President Abraham Lincoln signed Congressional legislation that was intended to provide a northern transcontinental railroad from Lake Superior to Puget Sound. While a railroad did not enter Montana Territory for more than another 15 years, the Legislative Assembly began to shape Territorial regulation of railroads almost immediately. Taxation of railroads was an important part of this early phase in which lawmakers codified railroad taxation.

The third territorial legislative session was the first assembly to deal directly with the taxation of railroads. This session imposed a $1 head tax on "every person leaving the Territory, by any railroad, stagecoach, carriage, omnibus [or] wagon. . . ." This provision was never enforced. The Fifth Legislature provided a more realistic method of direct taxation when it established mill levies upon railroad properties.

While taxation policy took form quietly in the late 1860s, it became a heated issue during the 1870s. Since no railroad actually entered Montana until 1880, the decade of the 1870s was characterized more by schemes of encouraging such roads to build into Montana Territory. The two biggest incentives discussed during this time were subsidies to railroads and tax exemption of railroad property.

Several territorial legislative assemblies passed subsidy bills that authorized either the Territory or individual counties to aid railroads through bond subsidies. In 1876, for example, representatives of the Northern Pacific Railroad petitioned the Territorial House for a $2 million territorial subsidy, consisting of 25-year, 8% bonds that

were to be secured by a lien upon the railroad's Montana traffic.

The representatives asked for the subsidy "without any taxation whatever". (Myers, p. 30.) In return for the aid, the railroad promised to construct 200 miles of road into the Territory.

By February 11, 1876, when the Legislative Assembly adjourned, three railroad subsidy bills had passed that provided $3 million for the Northern Pacific (NP), $1,150,000 for the Utah Northern, and $750,000 in county bonds to assist the Helena-Fort Benton railroad. The legislation contained no provisions for tax exemptions. (Myers, p. 31.) The subsidies had to be ratified by the electorate. The first two proposals were narrowly defeated by state voters after vigorous publicity campaigns. Lewis and Clark County voters gave the Helena-Fort Benton bond issue overwhelming support.

The idea of tax exemptions for railroad property received a good deal of attention during 1878 and 1879. Jay Gould, the railroad financier and owner of the Union Pacific Railroad Company, approached Samuel T. Hauser in August and again in December of 1878 to ask for aid in securing a tax exemption for the Utah and Northern Railroad. Since Territorial legislatures had in the past exempted from taxation such things as mines, water ditches, and woolen mills, Gould had ample reason to think that railroads could be similarly treated. (Myers, p. 35-6.)

The Territorial governor was sympathetic to such an idea. In his message to the Eleventh Legislative Assembly, Governor Potts asked the Legislature to approach the question of a tax exemption for railroads with "calm and impartial consideration".

Legislators Granville Stuart and W. F. Sanders together maneuvered a tax exemption measure through the House by a vote of 14 to 12. The measure was killed the next day in the Council [upper house] by a margin of 11 to 2. With this avenue of exemption blocked, Stuart and Sanders introduced a second measure that would have submitted to the voters of Lewis and Clark County a proposal enabling them to pay the Utah and Northern's taxes in exchange for construction of a line to Helena. Again the measure passed the House by a substantial measure but died in the Council.

But the issue of tax exemptions did not die with the end of the legislative session. In July 1879 Governor Potts called the Legislative Assembly back into session to consider several finance, Indian, and railroad issues. The Governor's messages included a call to accept an offer from the Union Pacific Railroad Company to extend its lines into Montana in 1880 if the Legislature would exempt the construction from taxation for 15 years. Governor Potts pointed out in his message to the Eleventh Legislative Assembly that the "officers of the Union Pacific Railroad Company do not hesitate to say that the Utah and Northern Railroad will <u>not</u> be extended any further north unless friendly legislation is extended." (Governor's Message, Journals of the Council and the House, Extraordinary Session of the Eleventh Legislative Assembly of the Territory of Montana, July 1 - 22, 1879, p. 13-14.)

Measures were again introduced in the Legislature for railroad subsidies and tax exemptions. The day after the bills were introduced, five members of the Council disappeared from their desks in the Council chambers and remained absent for five days. The Council was unable to transact business without a quorum. When a quorum was established, both the subsidy and exemption measures were defeated.

Both the regular and special sessions of 1879 confirmed Montana Territory's attitude toward railroad taxation. Despite the fears of the five Council members, Jay Gould's tax exemption idea met with hostile reactions and the Territory retained its powers of railroad taxation.

Gould and other railroad officials turned their attention back to constructing railroads. The Union Pacific's Utah and Northern Railroad entered Montana at Monida Pass on March 9, 1880 -- Montana Territory had a railroad. When the Northern Pacific crossed into Montana from the east in December 1880, the Territory acquired a second railroad.

Montana's second railroad, the Northern Pacific, presented the Territory with a unique taxation problem. While the Territorial Legislature had firmly established and maintained its taxation authority relating to railroads, the Northern Pacific's 1864 Charter signed by President Lincoln contained a provision that allowed only states -- not territories -- to tax the railroad's right-of-way and property within 200 feet of the tracks. Less than 5 months after the official completion of Northern Pacific's transcontinental railroad, Montanans gathered in Helena in a Constitutional Convention to discuss statehood.

Railroad regulation was an important item on the Convention's agenda. Article XV of the 1884 Constitution contained 19 sections dealing with corporations and embodied most of the material that regulated railroads. Article XIII, titled "Public Indebtedness", contained two sections that prohibited state and local governments from aiding corporations either through subsidies, tax exemptions, or stock subscriptions.

When the necessity of the 1884 Constitution was explained to voters, one of the reasons cited by proponents for adopting it was to subject all railroads to taxation. Although the electorate overwhelmingly approved the 1884 document, statehood was withheld until 1889.

Taxation: Statehood to 1920

The 1889 Constitutional Convention spent little time on railroad matters but adopted for the most part the transportation provisions of the proposed 1884 Constitution. Three sections of Article XII, "Revenue and Taxation", dealt with railroad taxation. Sections 7 and 17 specifically reserved the right of taxation on all corporate and private property, including stocks, bonds, and franchises. Section 16 charged the State Board of Equalization with assessment and taxation of railroad property operating in more than one county and allocating railroad values to local taxing jurisdictions. Other than a wishful comment by Paris Gibson that since railroads greatly benefited Montana they should therefore be exempt from taxation, the sections on railroad taxation passed without debate; the electorate ratified the entire Constitution by a vote of 24,676 to 2,274. (Myers, p. 67.)

The State Board of Equalization met for 2 weeks in August 1890 to organize the collection of taxes in the new State of Montana. The Board immediately became entangled in legal arguments about the taxation of railroads. Governor Joseph K. Toole, the lone Democrat on the Board, wanted railroad per-mile assessments to be equal and to apply to the (theretofore) exempt Northern Pacific Railroad. Other members of the Board supported an opinion offered by Secretary of State Louis Rotwitt that under the 1864 federal land grant charter Northern Pacific Railroad was exempt from property taxation and that the exemption was a continuous, vested right of the company. Governor Toole argued that the exemption provision

applied only to territorial governments, not to the State of Montana. After debate, and at Rotwitt's suggestion, the Board compromised by assessing all railroad rolling stock, right-of-way, roadbed, etc., at $5,000 per mile -- except the Northern Pacific, for which the rate was $2,500 per mile. During 1891 and 1892 the Board basically continued a practice of unequal assessments and partial exemption for the Northern Pacific: the Oregon Short Line, the Montana Union, and the Montana Central were assessed at $5,000 per mile; the Great Northern main line and its subsidiaries were assessed at $4,000 and $3,000 respectively; the Northern Pacific main line was valued at $2,835, while its branches were assessed at $4,000 per mile. The Northern Pacific was assessed as follows:

Main line:	
Roadway	$ 100 per mile
Roadbed	400 per mile
Rails	700 per mile
Rolling Stock	1,635 per mile
TOTAL	$2,835 per mile
Branch lines	
Roadway	$ 100 per mile
Roadbed	1,900 per mile
Rails	2,000 per mile
TOTAL	$4,000 per mile

(Source: Meyers, p. 92, State Board of Equalization, 1st, 3rd, and 4th Annual Reports.)

The unequal assessment of railroads was a minor issue in the gubernatorial election of 1892, with the Democratic candidate, Timothy E. Collins, charging the Republicans on the Board of Equalization of belonging "body, soul and breeches" to the Northern Pacific. Despite the charges, the railroad assessments remained unchanged for the next 4 years.

In 1896 a new administration came to Helena that was interested in changing assessments for railroads. Governor Robert Smith asked the 1897 Legislature to pass a constitutional amendment requiring railroads, particularly Northern Pacific, to pay more taxes. Neither this suggestion nor suggestions to the following Legislature for taxes on express companies, the Pullman Car company, and private car companies received approval.

Unable to change taxation directly through the Legislature, the new administration turned to the State Board of Equalization, on which the Governor was an ex officio member. The Board moved to increase Northern Pacific's valuation from $2,835 to $5,100 per mile. The change increased the taxable value of railroads in the state from 1896 to 1897 by over $2 million. (Trackage increased only 62 miles during the same period.) For the next 4 years assessments were: $5,800 per mile for the NP main line; $5,300 per mile for the Great Northern; $6,500 per mile on the Oregon Short Line; and $7,500 to $8,000 on the Montana Central and the Butte, Anaconda and Pacific -- railroads whose entire physical plant lay entirely within the state. (Meyers, p. 100.) Assessments remained about the same for the next 5 years.

The 1901 formation of the Northern Securities Company, a trust created by railroad men James J. Hill and Edward H. Harrison alarmed the governors of several states. Governor Toole, serving a second term as Governor, acted as a moderator with representatives from Minnesota, South Dakota, Idaho, Washington, and Montana who were convinced that the Northern Securities Company arrangement violated antitrust laws in their states.

Against this background, the July 30 to August 2, 1902, meeting of the State Board of Equalization took on added significance. A group of county commissioners and assessors presented the Board of Equalization with a petition which asserted that while local property was assessed "at nearly and in some cases more than the full cash value, railroads of the State are not assessed at over one-eighth of their actual value." (Thirteenth Annual Report, p. 34.) The local representatives asked that the State Board begin assessing railroads at the same percentage of value as other property. Petitions signed by several hundred citizens from Broadwater, Lewis and Clark, and Ravalli counties asking for substantial increases in railroad assessments were presented to the Board of Equalization at the same time. (Thirteenth Annual Report, p. 34-5.)

Responding on August 1 to the petitions, Governor Toole dropped what must have been a bombshell. The Governor reminded the State Board that the law required property to be assessed at cash value, and noting that that was not always an easy task, he went on to tell the Board that such difficulty had been "removed to some extent in the case of the Northern Pacific and Great Northern, which were recently sold on a mileage basis of $52,800 per mile." (Thirteenth Annual Report, p. 35.)

The $52,800 per mile sale price was part of the financial arrangements involved in the Northern Securities corporate arrangements between Jim Hill, Edward Harriman, and others. Governor Toole said that he would even accept discounting the market value by 44%, a figure which railroad representatives had argued was the assessment/sales ratio for livestock. Governor Toole's actual recommendations encompassed an even lower discount but still increased the valuation of the Great Northern, Northern Pacific, and Montana Central (including each system's branch lines) by 300% over the 1901

assessments. Since, according to the Governor, the railroads in the state were "with few exceptions enjoying the highest degree of prosperity", he thought such increases were fair.

The Governor's recommendations lead to a long afternoon of motions, deadlock, and amendments. By the end of the meeting the Board had agreed on consistent votes of 3 to 2 to assess the major lines at the rate of $16,000 per mile. The Governor seemed satisfied with the compromise, noting that the valuation set by the Board seemed "so low as to preclude the possibility of injury or injustice to the roads." (Thirteenth Annual Report, p. 42.)

Representatives of the railroads did not agree. R. A. Wilkenson of the Great Northern notified the Board that the railroad representatives would like to present their opposition to the increases the following week.

On August 9, the railroads responded. Spokesmen presented copious material on railroad values in other states for comparison to Montana. The comparisons were based on value per mile, taxes per mile, and Wisconsin's gross earnings tax. Those testifying for the railroads tried to convince the Board that under any test, the Montana assessment at $16,000 per mile was "a burden of taxation per mile not borne by any railroad in the West." (Thirteenth Annual Report, p. 46.) G. S. Fernand, representing the Northern Pacific, summed up the railroad's feelings about the State Board's new values by imploring the Board:

> Don't leave this assessment, gentlemen, up to such a height, this assessment of 1902, that it will practically amount to a monument on the borders of your State with the inscription on it "We want no more railroads in Montana...." (Thirteenth Annual Report, p. 52.)

The final witness made a plea that the Board members take up the matter of valuation de novo -- "unembarrassed by anything that has been done heretofore." (Thirteenth Annual Report, p. 59.)

Mr. Parker Veasey, representing the Great Northern Railway, drew a clear picture for the Board of what was involved in the Board's efforts to equalize railroad assessments.

> I think I appreciate the difficulty of any honorable public man, or even any private citizen, in undertaking to determine what is the real value or even the approximate value, or mileage of railroads, generally, or of railroads in Montana. I confess that it seems to me to be a very difficult question. I don't know what is the value of railroads in Montana per mile, and I don't think you do, gentlemen, I don't think any of us do. After all, it must be the result of an honest guess, it must be an estimate more or less in the dark and in an honest effort to reach some fair estimate it would seem unavoidable that you must seek light from other sources, not mere tabulations of supposed values such as could be fixed in estimating real estate or personal property here. (Thirteenth Annual Report, p. 59.)

While Mr. Veasey was not convinced that real values were knowable, he was certain that policy makers could determine equitable tax burdens:

> You can determine what proportion of the burden of taxation we should pay, we ought to pay, we ought to pay it cheerfully and we will. But when you find that any measure you have used, or anybody else used, and it results in our paying more than that proportion, no matter what figures you have used or what measures you have resorted to, I earnestly beg to inform you that you are wrong if they lead to our paying $300 or $400 a mile when no other system of taxation produces any such result. (Thirteenth Annual Report, p. 61.)

The State Board was not unimpressed. Following the hearing assessed values for main lines were reduced to $12,500; branch line values depended upon condition of track, rolling stock, and so forth.

The basis of valuation established for the 1902 assessment did two things. First, the assessment of railroads -- and therefore taxes -- doubled from an assessed valuation of $16,667,803 in 1901 to $32,946,957 in 1902. At the same time, the values hammered out in August of 1902 equalized the assessments among the major railway lines for the first time in Montana's history. (Thirteenth Annual Report, p. 62.)

The State Board increased assessments in 1903 by a flat 10% (to $14,080); in 1904 the assessment was set at $14,432, and in 1906 the assessment was set at $16,236 per mile. In 1907 and 1908 the assessments went to $17,250. By 1917, the assessments were $21,250 per mile. Other than the increases in valuation, the decade between 1907 and 1917 saw little attention paid to railroad assessments and taxation. (Meyers, fn., p. 128, 157.)

By 1917 the focus of legislative attention had turned to investigations of the taxation of mines. The Tax Investigation Committee of the Senate examined the proportion of total taxes paid by various industries in the state and found substantial differences between such industries, particularly mining. Railroads, the Committee concluded, "are paying their proportionate share of taxes". (Report of the Tax Investigation Committee of the Senate, Fifteenth Legislative Assembly (Helena, Montana: 1917), p. 7.)

During the 1917-1919 interim a newly formed Tax and License Commission studied Montana taxation. The Commission's final report, in which was recommended a classified property tax system, noted "the great variety of opinion among tax authorities as to the proper method of assessment" of public utilities and that the determination of value was "always attended with great difficulty." The Commission noted the difficulties with determining value, stated its judgment that some utilities were paying their fair share of taxes and others were not, and recommended a state taxing authority that would be equipped to determine value on a consistent basis. (Tax and License Commission Report, p. 32.)

It is important to remember that tax policies and recommendations were not formed in a vacuum -- indeed, taxation policy was only one element in Montana's relationship with railroads in the period between 1889 and the first decade of the new century. Taxation policy was formed against a background of broadening public demands for state and federal regulation of railroads, a demand that in Montana culminated in 1907 with the creation of the Montana Board of Railroad Commissioners. The broad outlines of railroad equalization, a method of valuation, and therefore taxation policy were established in Montana by 1902. The principles remained intact until 1920.

Taxation: 1920 TO 1960

Three legislative sessions from 1919 to 1921 reshaped many aspects of Montana's taxation system and continued the scrutiny begun in earlier sessions regarding the State's major taxpayers. The outcome of these three sessions was the establishment of a classified property tax system, a new appointed State Board of Equalization, and several changes in tax laws. For the railroad industry, the sessions redesigned the method of railroad valuation and passed

legislation to assess the Pullman and American Express companies.

The most important change for both the State and the railroads was the redesigned method of valuation initiated in 1920 by the State Board of Equalization. By 1920 the discussion of valuing railroads had become much more sophisticated than the arguments of 20 years earlier, which had been based on attempts to find a value of Montana railroads per mile. A participant in the Farmers Tax Conference in Lewistown in 1918 had stated the need for a different system:

> It is often said that railroads should be valued and assessed like other property and that neither the companies nor the public can then have reason for complaint. It is a fair sounding proposition, but shows a failure ti [sic] recognize the fundamental fact that railway property cannot be valued like other property because it is essentially unlike other property and it is not susceptible to like treatment. (SC 234, Farmers Tax Conference, p. 259-60.)

The valuation method initiated in 1920 was a unit method which valued a railroad's entire operating system or unit and then allocated a portion of that value to Montana. In 1924 the State Board of Equalization described in some detail the unit appraisal system as applied to railroads and other utilities. The method consisted of examining indexes of value from reproduction cost new, stock and bond values, and capitalization of net operating revenue. Equal weights were apparently given to each of the three indicators of value in order to arrive at the "true cash value" of the system.

A "composite factor" was then applied to the true cash value of the entire system to determine Montana's share of the system's value. The Board deducted the value of property

assessed by local assessors, allocating to local jurisdictions only the difference between the local assessment and the value of the system in the state. The allocations to local jurisdictions were based on the number of miles of track. (Report to the Board of Equalization, 1924, pp. 17-18.)

True cash values were derived from several sources. The 1924 Report of the Board indicated that reproduction cost new was obtained from Interstate Commerce Commission reports, if available, or from the annual reports of each railroad. The stock and bond method employed by the Board used an average five-year sales price for a company's stocks and bonds. The Report noted that such an average had a "tendency toward stability and obviates extreme increases or decreases." (Report of the Board of Equalization, 1924, p. 17.)

The Board examined each company's annual report to find a capitalized net operating revenue (i.e., revenue after taxes but before the payment of interest) indicating a value for the entire system. The net operating revenue was averaged for a 5-year period, the 5-year average was applied each year and "capitalized at a fair rate of interest -- for the year 1924 eight per cent was used." (Report of the Board of Equalization, 1924, p. 18.)

Beginning in 1920, the unit value system integrated railroad and other utility property assessments with a company's operating profits and losses as opposed to the earlier system that attached a seemingly arbitrary and ever-increasing per-mile assessment. Just as importantly, the new valuation method constituted an acknowledgement by the State of the interstate nature of railroad and utility property. (Meyers, p. 184-186.)

The major outlines of railroad classification, valuation, and equalization were firmly established in Montana by the mid-1920s. There have been no significant modifications to the overall structure since the 1920s.

In the late 1950s a discussion of utility taxation caught both the public's and the Legislature's attention when the State Board of Equalization attempted to equalize utility assessments with the general level of statewide property assessments.

In 1959 the State Board of Equalization reduced the assessed value of Montana's major utilities by almost $35 million -- a 12.7% decrease from the previous year. The equalization attempt was based on sales ratio studies conducted by utility companies in concert with the Board of Equalization. According to the Board, the statewide average level of assessments for all types of locally assessed property was 35 to 37% of true value, while centrally assessed utilities averaged 20% higher.

According to Mr. Vern Miller, Director of Administration and Secretary of the State Board of Equalization, the 1959 reductions by the Board were aimed at a long-term program of statewide equalization. Mr. Miller testified in 1970 before a legislative subcommittee:

> In 1959 the State Board of Equalization met with representatives of all of the public utilities and railroads for the purpose of keeping the utilities and railroads out of court and to agree with the State Board that they would accept a gradual reduction over a five-year period of what the board termed the equalized value while they were trying to bring local assessments up. They were aiming at the time at 40%. The Board tried to get county assessors to raise their value to 40%. If utilities were assessed 15 percentage points high, then it meant 3 percentage points per year. Some [utilities] were assessed at 90% that year. The

> only way that the Board has been able to bring this equalization factor down is in those utilities where there is enough growth to offset any loss. (Board of Railroad Commissioners, Ex Officio Public Service Commission of Montana, (Montana Legislative Council; December, 1970) Report No. 36, p. 10.)

The controversy that ensued in 1959 and 1960 shed light on assessment practices of both local and state assessment offices. Members and attorneys representing the State Board of Equalization provided various estimates of assessment levels for property in the state.

The chairman of the Board estimated that cattle were being assessed on a statewide basis at 40% of full value; stocks and merchandise were between 20% and 30%; farm machinery was about 50% of value; and passenger vehicles were 66 2/3% of list price. A member of the Board, Mr. Byrne, testified in district court that livestock was assessed at about 70% of value; oilfield machinery was about 50% of original cost irrespective of age; lumber was about 60% of value; agricultural products in storage were assessed at approximately full value, as were net proceeds of mines; and patented mining claims were assessed the price paid the federal government.

The Board's attorney argued before the Montana Supreme Court that the assessments made on the state level by the Board comprised about 25% of the statewide tax base and that these assessments ranged from 60-85% of the Board's unit determination of market value. (Property Taxation in Montana, (Montana Legislative Council: December 1960), p. 58.)

While there were inconsistencies between the various statements of members and their lawyers, there were also inconsistencies when it came to applying "equalization factors" to the value of utility property that the Board was reducing

for equalization purposes in 1959. According to a legislative report:

> . . . the board reduced utility assessments in an attempt to equalize among different classes of property, yet it has not equalized among utilities themselves. The equalization factor which the board applies to its unit appraisal is not the same for all utilities. By the board's own admission, in 1959 the assessed to full value ratio varied from 74.8% to 34.35% for railroads and from 65.5% to 46.5% for other utilities. (Property Taxation in Montana, Montana Legislative Council: December 1960, p. 59. Emphasis added.)

The 1959 attempt by the Board to equalize utility property with other property in the State brought out several issues. First, at least as far as the legislative committee that examined the Board's actions was concerned, there was solid agreement that equalization was important. However, the legislative committee disagreed with the Board's methods, methods characterized as "largely based on real estate sales ratio studies conducted by some of the larger utilities owning property in the state." (Property Taxation in Montana, (Montana Legislative Council: December 1960), p. 54.) The Committee felt that the Board should do its own studies and that such studies should be comprehensive enough to enable the Board to "equalize not for one class of taxpayers but for all classes and for individuals within classes." (Property Taxation in Montana, (Montana Legislative Council: December 1960), p. 59.)

For today's observer the 1959 attempt at equalization illustrates another issue and provides an enormous frustration. The statements of Board members and the reports of the legislative committee provide evidence that the unit value applied to railroads before and after 1959 was reduced by an "equalization factor", and that the equalization factor varied from property to property. Therefore, the

assessed values of railroad property, presented in Appendix A, are unlikely to be the actual unit value of railroads allocated to Montana. Without knowing the "equalization factor" for each year the figures are of limited use in comparing railroad property with other property in the state.

TAXATION: CHANGES IN RAILROAD ASSESSMENT PROCEDURES

The philosophical basis of establishing railroad values that are to be exposed to state and local property tax levies has not changed since the 1920s. The unit method of appraisal procedure still applies. This method values the entire value of a company's operating property as a whole, without regard to its constituent parts. The details of how the final unit value of a railroad is arrived at, however, have changed substantially, particularly in the last few years. The changes have involved four areas: weights applied to indications of value; averages used to determine the earnings that are capitalized; capitalization rates used to capitalize net earnings; and the treatment of locally assessed railroad operating property. (The source of 1970s and 1980s information in this section is from the Inter-County Bureau Chief, Department of Revenue, and conversations with Ken Morrison, Administrator of the Income Tax Division, Department of Revenue. Mr. Morrison worked with railroad assessments in the transitional period, i.e., when the State Board of Equalization was abolished and the Department of Revenue was established. The historical information is from Property Taxation in Montana, 1960, p. 43-50.)

From the 1920s to the 1960s the State Board of Equalization, in applying the unit rule of appraisal to railroads, examined the three indications of value (cost, income, and

market) and generally assigned each of the three components an equal weight -- 33 1/3% -- in order to arrive at the total unit value of the railroad property.

Sometime prior to 1982, the system for weighting values changed slightly -- to 35%/35%/30% for cost, income, and market, respectively. This weighting scheme lasted until 1983 when the Department of Revenue began applying weights of 10%/50%/40%. This meant a shift from the cost indicator to much more reliance on the income indicator and slightly more reliance on the market indicator.

The earnings that are capitalized must be established for each assessment year. Historically, the earnings of railroads were established by the State Board of Equalization using an unweighted 5-year average. This began to change in 1973 when an "adjusted" 5-year average was applied, and a year later the average was reduced to three years. A 2-year average was used in 1975, and 3-year averages were used for the two following years. Since 1978, the standard has been to establish earnings using a 2-year average.

The market indicator (stocks and bonds) was also on a 5-year average from the early 1920s until the time that the Department of Revenue assumed control of state tax administration. Beginning in 1973, the market indicator was based on a 12-month average.

Once the net earnings figure is established for an assessment year, the tax administrator is required to fix a capitalization rate for the earnings. Prior to the 1960s, the Board apparently applied a standard capitalization rate of 6% -- a rate that a legislative study described as being based on "nothing more than tradition". While it is not known precisely when this practice changed after 1960, since 1974 the capitalization rates have fluctuated significantly.

YEAR	CAPITALIZATION RATE ON EARNINGS
1974	8.25%
1975	8.75%
1976	9.75%
1977	10.00%
1978	10.50%
1979	11.50%
1980	12.50%
1981	14.00$
1982	15.00%
1983	12.50%

The final area of assessment practice that has changed significantly in the last decade is the manner in which the state treats locally assessed railroad operating property. Until 1979, the state taxing authority shared part of the assessing responsibility for railroads with the 56 county assessors. The state was charged with assessing the franchise, roadway, roadbeds, rails, rolling stock, and other railroad property not otherwise assessed. The local assessors were given the responsibility of assessing operating property such as furniture and fixtures, depots and other buildings located in their respective counties.

Once the state taxing authority established the unit value of a railroad, it would then subtract the locally assessed values. The remainder of the state's unit value was then allocated to local taxing jurisdictions based on track mileage.

This system had its critics. Some argued that the system led to high assessments by districts that contained substantial quantities of operating property -- a mechanism designed to capture as much of the "fixed railroad pie" as possible for the local district. Critics also argued that

the system was illogical, since it mixed both the unit rule appraisal method with a contradictory method that appraised individual components of property. A final criticism of assessing railroad operating property at both the state and local level was the contention that the local assessment of railroad property tended to lower the taxable value of such property because the classification rates applied to local property tended to be less than the 40% rate that applied to property assessed by the state. In other words, while the assessed value would always be what the state said it was, the greater the local assessment, the lower the taxable value would be. It is difficult, if not impossible, to imagine what the real effect of all this tended to be since it was possible that the lower taxable value may have been credited under this system to taxing districts with high mill levies.

The Legislature eliminated the system of shared assessment for centrally assessed properties in 1979. At the same time the rate applicable to centrally assessed property was decreased from 16% to 15%. Proponents of the change argued that the decreased rate would maintain the average tax effect in local jurisdictions. (House Bill 643, Chapter 686, Laws of 1979.)

FEDERAL CONSTRAINTS ON RAILROAD TAXATION: 1979 TO PRESENT

On July 16, 1979, Burlington Northern Railroad filed a suit in federal district court in Billings challenging the state's assessment of its property. The basis of the challenge was the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act) which prohibited state tax discrimination against railroad property. The Congressional act provided that railroad properties could not be assessed at a rate higher than the assessment on other commercial and

industrial property. Allegations of such discrimination were allowed to be pursued in federal court.

Burlington Northern's property tax payments that were due in November 1979 were paid under protest. At issue in the 1979 case was the classification rate of 16% applied to railroad property and the variety of classification rates applied to other property.

After negotiations between the railroad and the Department of Revenue, the parties agreed to a weighted average classification of all other property at 10.5%, with that percentage applied to rail transportation property. (See Appendix B.)

In 1980 Burlington Northern again brought suit under the 4-R Act. The suit alleged two issues:

1. the classification percentage issue of 1979; and

2. the issue of equalization of rail transportation property in relation to other commercial and industrial property.

Similar suits were filed in 1981 and 1982.

In December 1982 the Department of Revenue and Burlington Northern settled the pending lawsuits before the federal district court and agreed to negotiate issues that might arise for calendar years 1983, 1984, and 1985. The subsequent agreement worked out between the parties outlined a valuation and equalization process to be followed by the state during the 1983-85 tax years. (See Appendix C.) Also, as part of the agreement, both parties agreed to recommend to the 1983 Legislature the establishment of "an interim study committee to study the solution to problems

raised by equalization and classification questions in general and the problems raised by acts like Section 306 of the 4-R Act."

In addition, the agreement stipulated that:

> If the interim study does not address matters concerning the conducting of future sales assessment ratio studies in Montana and implementation of a personal property audit program the Department will recommend to the 1985 Legislature:
>
> a. That the Department of Revenue be authorized to implement a personal property audit program. This "audit" program could be based upon the program implemented and used by the State of Washington.
>
> b. That the Legislature implement procedures to conduct a sales assessment ratio study in the State of Montana beginning in 1986.

For a 3-year period Burlington Northern agreed not to challenge its ad valorem property tax assessments with respect to valuation, classification, or equalization under the 4-R Act if the terms of the agreement were fulfilled.

CONGRESSIONAL HEARINGS RELATING TO SECTION 306 OF THE 4-R ACT

Ten railroads went bankrupt in the United States between 1967 and 1984. One of the lines, the Penn Central, was the largest bankruptcy in American history. The U.S. Congress has reacted to such events with several major pieces of legislation. The Congress began by providing railroads relief from passenger service through the formation of Amtrak in 1971. The remainder of the 1970s witnessed two other acts that were Congressional responses to deteriorating railroad conditions in the United States.

In 1973, Congress enacted the Regional Rail Reorganization Act of 1973 (3-R Act). This act dealt with northeastern

railroad problems by setting up the Railway Association that was to establish a plan for the future rebuilding and revitalization of the northeastern rail network. The Railway Association's recommendations resulted in establishment of Conrail -- a streamlined version of the old rail network. Conrail was to receive roughly $4 billion in subsidies between 1976 and 1981.

The 4-R Act (Railroad Revitalization and Regulatory Reform Act of 1976) continued earlier policy development. This act was in response to the realization that railroad problems were not limited to the northeast. The Katy line was bankrupt and the Rock Island and Milwaukee were on the verge of bankruptcy. The 4-R Act, as its name implied, contained two policy aims: one was to provide government subsidies; the other was to reform regulatory practices developed over the past 100 years that related to rates, abandonments, and mergers. (Keeler, pp. 31-3.)

The focus of this discussion is Section 306 of the 4-R Act. The section was included in the 4-R Act under Title III, "Reform of the Interstate Commerce Commission". Section 306 prohibits discriminatory tax treatment of railroad transportation property by states. No Congressional hearings were held on Section 306; adoption of the section was done with little discussion or debate. (Glenn W. Fisher, The Four-R Act and the Taxation of Transportation Property, p. 2.)

The text of Section 306 is as follows:

> (1) Notwithstanding the provisions of section 202(b), any action described in this subsection is declared to constitute an unreasonable and unjust discrimination against, and an undue burden on, interstate commerce. It is unlawful for a state, a political subdivision of a State, or a governmental entity or person acting on behalf of such State or subdivision to commit any of the following prohibited acts:

(a) The assessment (but only to the extent of any portion based on excessive values as hereinafter described), for purposes of a property tax levied by any taxing district, of transportation property at a value which bears a higher ratio to true market value of such transportation property than the ratio which the assessed value of all other commercial and industrial property in the same jurisdiction bears to the true market value of all such other commercial and industrial property.
(b) The levy or collection of any tax on an assessment which is unlawful under subdivision (a).
(c) The levy or collection of any ad valorem property tax on transportation property at a tax rate higher than the tax rate generally applicable to commercial and industrial property in the same assessment jurisdiction.
(d) The imposition of any other tax which results in discriminatory treatment of a common carrier by railroad subject to this part.

(2) Notwithstanding any provision of section 1341 of title 28, United States Code, or of the constitution or laws of any State, the district courts of the United States shall have jurisdiction, without regard to amount in controversy or citizenship of the parties, to grant such mandatory or prohibitive injunctive relief, interim equitable relief, and declaratory judgments as may be necessary to prevent, restrain, or terminate any act in violation of this section, except that --

(a) such jurisdiction shall not be exclusive of the jurisdiction which any Federal or State court may have in the absence of this subsection;
(b) the provisions of this section shall not become effective until 3 years after the date of enactment of this section;
(c) no relief may be granted under this section unless the ratio of assessed value to true market value, with respect to transportation property, exceeds by at least 5 percentum the ratio of assessed value to true market value, with respect to all other commercial and industrial property in the same assessment jurisdiction;
(d) the burden of proof with respect to the determination of assessed value and true market value shall be that declared by the applicable State law; and
(e) in the event that the ratio of the assessed value of all other commercial and industrial property in the assessment jurisdiction to the

true market value of all such other commercial and industrial property cannot be established through the random-sampling method known as a sales assessment ratio study (conducted in accordance with statistical principles applicable to such studies) to the satisfaction of the court hearing the complaint that transportation property has been or is being assessed or taxed in contravention of the provisions of this section, then the court shall hold unlawful an assessment of such transportation property at a value which bears a higher ratio to the true market value of such transportation property than the assessed value of all other property in the assessment jurisdiction in which is included such taxing district and subject to a property tax levy bears to the true market value of all such other property, and the collection of any ad valorem property tax on such transportation property at a tax rate higher than the tax rate generally applicable to taxable property in the taxing district.

(3) As used in this section, the term --

(a) "assessment" means valuation for purposes of a property tax levied by any taxing district;
(b) "assessment jurisdiction" means a geographical area, such as a state or a county, city, township, or special purpose district within such state, which is a unit for purposes of determining the assessed value of property for ad valorem taxation;
(c) "commercial and industrial property" or "all other commercial and industrial property" means all property, real or personal, other than transportation property and land used primarily for agricultural purposes or primarily for the purpose of growing timber, which is devoted to a commercial or industrial use and which is subject to a property tax levy; and
(d) "transportation property" means transportation property, as defined in regulations of the Commission, which is owned or used by a common carrier by railroad subject to this part or which is owned by the National Passenger Corporation.

[NOTE: Section 306 was originally codified at 49 U.S.C. 26c but due to a recodification, Section 306 is now codified at 49 U.S.C. Section 11503. The recodification of Section 306 made some substantive changes in it. As a result, most of the courts that have considered this section use the original version under the principle that

recodification is not meant to create substantive changes.]

While it is accurate to say that Congress held no hearings on Section 306 of the 4-R Act, there were hearings before both the Senate and the House on the idea of prohibiting discriminatory taxation of railroad transportation property. Allegations of discriminatory taxation of railroads began as early as 1944 when Congress received a report which said:

> The officials of approximately half the States readily concede that railroads are being overtaxed because of inadequate equalization.... If we accept the standards of equity set forth in present tax laws, this failure to equalize State and local assessments is probably the most significant of the railroad tax grievances. (Letter from Board of Investigation and Research transmitting a Report on Carrier Transportation, House Document No. 160, 79th Congress, September 19, 1944.)

Legislative action on these allegations began with the 1961 Doyle Report. General Doyle headed a study group that examined transportation policies in the United States and presented a comprehensive report to the Senate Committee on Commerce. The Doyle Report purported to show that railroads in 1957 paid excessive ad valorem taxes to 31 states amounting to $141 million -- about 54% of the railroads' property tax bill in those states. A number of similar studies followed that purported to demonstrate the same tax discriminations. (Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives, Eighty-Ninth Congress, 2nd Session on H.R. 4972, Serial No. 89-30, 1966, p. 12.)

The Doyle Report directly addressed the issue of state taxation of interstate transportation property. The Report mused about several alternatives to restrict state taxation of regulated interstate common carrier property and settled

on a recommendation to exempt railroad and pipeline rights-of-way from property taxation since it was a "unique tax burden" not imposed on carriers that used publicly provided ways.

As an "additional or alternative" proposal the Doyle Report cited a suggestion offered by the Association of American Railroads that proposed a federal law which would declare the following actions by a state to "constitute an unreasonable and unjust burden upon interstate commerce":

> (a) The assessment, for the purposes of a property tax levied by any taxing district, of property owned or used by any common carrier engaged in interstate commerce at a value which bears a higher ratio to the true market value of such property than the assessed value of all other property in the taxing district subject to the same property tax levy bears to the true market value of all such property.
>
> (b) The collection of any tax on the portion of said assessment so declared to be unlawful.
>
> (The language comes from section 13(4) of the Interstate Commerce Act relating to state actions in the matter of rail rates and services.)

This alternative, as opposed to the Doyle Report's recommendation on right-of-way exemption, became the basis for (the Section 306-type legislation). The Subcommittee on Transportation and Aeronautics of the House Committee on Interstate and Foreign Commerce held hearings on the proposal in 1964. The Committee took no action on the legislation.

Hearings were held again by the same committee in 1966. House Resolution 4972 and 12 identical bills were heard on March 1 and 2, 1966. The provisions of H.R. 4972 followed the general structure of the recommendation made in the Doyle Report by the Association of American Railways and added a provision that the federal courts were to be given nonexclusive jurisdiction of alleged violations of the act.

The emphasis, therefore, of these early bills was on equalization of assessments and effective relief in federal courts from inconsistent assessment practices that burdened interstate commerce.

Discussions and arguments in the 1966 hearings covered scores of pages in the official transcripts. The material formed the basis of much that came in later hearings. Officials for the railroads presented at the hearing a case suggesting consistent overassessment of railroads in the United States. James N. Ogden represented the Association of American Railroads. Mr. Ogden testified that the

> . . . added tax burden [on railroads] on account of discriminatory assessments is substantial to the point of being oppressive. During the 6 years that this legislation has been before the Congress, railroads have been overtaxed more than an estimated three-fourths of a billion dollars as a direct result of discriminatory assessments.
>
> That is a sum which, on today's market of about $10,000 a boxcar, would enable us to purchase outright and pay for 75,000 cars. If we wanted to buy the cars on time and pay 20 percent down, which is the way we usually do it, the industry could buy 375,000 boxcars with the money that represents an overtax in those years. (H.R. 4972 hearings, p. 13.)

Mr. Ogden presented the information in Chart 1 to illustrate the extent of tax discrimination in 20 selected states. Several states provided information to the hearing in opposition to H.R. 4972. Charles F. Conlon, Executive Secretary of the National Association of Tax Administrators, listed a number of reasons for states' objections to the bill.

House Resolution 4972 was objectionable, according to Mr. Conlon, because "carrier property would be frozen into a

CHART 1

State	1964 railroad ad valorem taxes (1)	All other 1964 State and local railroad taxes (2)	Percent of value at which railroad property assessed in 1964 (3)	Percent of value at which property of others assessed (4)	Estimated reduction in railroad ad valorem taxes if railroad assessments had been made at the same percent of value as were the assessments of property of others (5)	Percent of tax cases save
Alabama	$3 200 440	$2 315 560	40	20	$1 600 220	50
Arizona	8 381 673	316 327	76	38	6 705 340	80
California	24 732 616	5 006 384	42	22	13 624 300	47
Idaho	4 512 592	281 408	40	16	2 707 555	60
Iowa	6 841 502	96 498	60	25	3 994 106	58
Kansas	12 766 613	621 387	50	20	7 659 796	60
Louisiana	4 165 341	1 620 659	40	20	2 082 671	50
Mississippi	2 822 748	611 252	30	14	1 496 056	53
Missouri	9 255 081	888 919	50	30	3 745 832	40
Montana	6 026 541	149 459	50	25	3 013 271	50
New Mexico	2 453 815	330 182	70	20	1 742 211	71
North Dakota	4 630 196	125 804	45	27	1 972 042	40
Ohio	24 459 469	2 681 531	100	55	13 009 761	45
Oklahoma	5 933 042	357 958	40	20	2 966 521	50
South Carolina	2 468 585	1 100 415	42	10	1 870 125	76
South Dakota	1 051 379	30 621	60	45	262 845	25
Tennessee	7 630 907	2 260 093	95	30	5 189 017	68
Utah	4 564 202	422 798	28	16	1 916 965	42
Virginia	7 522 320	6 043 680	40	33	1 278 794	17
Wyoming	3 550 477	43 523	60	20	2 343 315	66
Total	147 199 512	26 211 488	.....	.....	75 052 743	51

NOTE.—Since 1964 certain of the States listed above (notably North Dakota and Montana) have taken action to bring the level of railroad assessments closer to the level of assessments of other property. However, the reverse is true in other States.

SOURCE: Cited in: "Federal Constraints on State Taxation of Railroad Property", Report to the Revenue Oversight Committee, by Jim Oppedahl and J. Cort Harrington, Montana Legislative Council, Helena, Montana, March, 1984.

preferred status" under the bill in classified property states. (1966 Hearing, p. 78.) Mr. Conlon argued:

> Whether property should be classified, and how, is a matter of State policy and so long as the classifications are reasonable, there is no warrant for Federal intervention in this field. (Hearing, p. 78.)

Secondly, since the bill covered all carrier property -- including nonoperating property -- Mr. Conlon objected to what he saw as a "special tax status" for this property that would be "objectionable on constitutional grounds". (1966 Hearings, p. 79.)

The proposal in H.R. 4972 to "substitute a special injunctive procedure in the federal courts for the administrative and review procedures" provided by state laws raised the question of whether such relief was needed and whether the alleged discrimination against transportation property existed when compared to assessments against all other property. (1966 Hearings, p. 79.)

On these two issues Mr. Conlon outlined the position of the states that he represented. He argued that specific relief was being granted in many states where the taxpayer proved that his property was being assessed at a higher percentage of true value than the property of other taxpayers. States, in his opinion, were developing a practice of giving predominant consideration to uniformity of assessment as opposed to compliance with a legal standard established by constitution or statute.

On the issue of tax assessment discrimination, Mr. Conlon noted:

> No one who was familiar with property tax assessment practices would deny that in many States assessments are not uniform over the whole range of properties taxed. This is a general problem and one by no means limited to common carrier property. (Hearings, 1966, p. 79.)

While not denying problems with uniformity of assessments, Mr. Conlon did dispute the evidence that had been presented which compared the assessment level of carrier property with that of other property. He contended that there was

> . . . no evidence which shows how railroad property assessments compare with those of other businesses. Second, in the case of locally assessed property, the average level of assessment may be determined within acceptable limits by sales comparison methods because some types of property

> involved usually change hands frequently and sales prices and tax assessments can be compared.... The property of carriers and other public utilities is not subject to such a sales comparison test because public utility companies are very infrequently sold as going concerns. Thus while the assessment ratios applicable to property generally are based on objective standards derived from Bureau of Census data, the assessment ratios attributed to the carrier properties are subjective. At the very least, they are not subject to the acid test of the market as are the ratios with which they are compared. (Hearings, 1966, p. 80.)

Mr. Conlon also tried to call into question what the bill meant when it asked for a comparison of all other property and transportation property. He argued that there was some doubt in his mind whether the comparisons were to be made on the average ratio of all other property, the average ratio of the most common class of property, or the highest ratio of any type of business property. (House Hearings, 1966, p. 83.)

The early hearings before the Congress provided a brief outline of the major issues and contentions that separated railroads and state officials. On the railroads' side was a contention that systematic discrimination existed against their property, that such discrimination was demonstrated in Bureau of Census materials which became available in the late 1950s, and that federal relief was necessary since state relief had been historically denied. Representatives of several states countered that where state administration failed in regards to uniformity it was a generic problem that cut across all types of property; that the states were, in fact, making substantial progress in developing relief measures to provide equity in assessments when taxpayers proved that inequity existed; and finally that there was no basis for rendering carrier property immune to reasonable state classification systems provided by state constitutions and statutes.

No action was taken by the House Committee on this bill in 1966.

In 1967 the Senate began consideration of Senate Bill 927. Hearings were held in August. Senate Bill 927 contained much of the language that had appeared in H.R. 4972 but added a new "subsection (c)" which prohibited a higher tax rate on transportation property than the rate applicable to other property in a taxing jurisdiction. Much of the new discussion that took place in the Senate hearings on S. 927 revolved around the provisions of subsection (c), relating to tax rates and property tax classification. There was also new discussion about how to determine the extent of any alleged discrimination.

Classification of property was a major item of discussion. Mr. Ogden, again testifying for the Association of American Railroads, responded to the Committee chairman's question about how railroads were affected by property tax classification systems. Mr. Ogden told the chairman that classification had created "an absolutely impossible problem for railroads." (1967 Senate Hearings, p. 11.) He continued by asking the Senate to:

> . . . seriously consider this bill because of a growing trend toward classification, where it does not now exist. I don't mean to suggest that all classification is bad. I mean, merely to say that it too can be abused if the legal authority is there. There has been State after State in the last 24 months where, in response to what appeared to be successful litigation by railroads or other tax people, they have threatened classification.... And that is just what we are talking of here, the threat of classification. Because as far as I know, I don't know of any defense we would have [against classification]. . . . (Senate Hearings, 1967, pp. 11-12.)

The Senate Committee chairman asked Mr. Ogden to explain the extent to which states could classify property. Mr. Ogden responded by saying that he thought the test of how far classification went was a question of reasonableness, which brought upon the following exchange:

> Mr. Ogden: [I] am merely pointing out that the Supreme Court of the United States has said pretty clearly that putting railroads in a class by themselves is not unreasonable where classification is authorized.
>
> The Chairman: Well, if the Supreme Court has said that, then it has declared that putting the railroads in a class by themselves comes within the law, then the classification must be reasonable. And would that then allow a different formula of assessment and a different rate of levying than is applicable to ordinary real estate?
>
> Mr. Ogden: That would be my understanding, sir. That is why I think we need the protection. I don't know what we would do if our property wasn't devoted to interstate commerce. And, of course, that is the basis on which we are here. It is devoted to interstate commerce and we need the protection and we are asking for it. (Senate Hearings, 1967, p. 12.)

When asked by Senator Pearson if the bill would "obviate or declare unlawful the power of a State to classify property for taxation purposes", Mr. Ogden responded that S. 927 would not outlaw classification, "but it would not permit a State to discriminate against a railroad through such classification." (Senate Hearings, 1967, p. 19.) When the same member pressed Mr. Ogden for further clarification on the classification issue, Mr. Ogden reiterated his position:

> . . . the State could do whatever it wished to do in relation to classification as far as others are concerned, but it couldn't use the power of classification to discriminate against the railroad. That is, it would relieve the railroads of the excess tax growing out of the classification.

> The rest of the State action remains the same. States can classify farms and homes and do it any way they want to. (Senate Hearings, 1967, p. 20.)

Since there seemed to be some confusion in the mind of Committee members as to the effect on tax rates of S. 927 in classified property tax states, Mr. Ogden submitted a supplemental statement. Mr. Ogden's statement, while somewhat long, is worth quoting at length:

> The carriers recognize the right and need for a State to establish separate rates for different classes of property. As an example, real property might be taxed at 50 cents per $100 of assessed value and tangible personalty at $100 of assessed value.
>
> The carriers do not contend by section (c) of S. 927 that all carrier property, both real and personal, should be assessed at the lower rate of 50 cents applicable to real property and do not believe any court would so rule. The carriers do object to, and would expect paragraph (c) to provide relief from, the levying of a 60-percent tax rate against carrier real property when the rate applied to real property of others was only 50 cents per $100 of assessed value.
>
> It has been suggested that the language of subsection (c) would prohibit traditional classification of property for rate purposes such as: One class to include all real property; another class for all tangible personal property; and still another class for all intangible property.
>
> This is not our interpretation of the bill. As we understand the bill it is intended to apply to the above illustration so as to permit such classification provided carrier transportation real property is taxed at no higher rate than other real property; that carrier transportation personal property is taxed at no higher rate than other personal property; and that carrier transportation intangibles are taxed at no higher rate than other intangible property.
>
> Furthermore, it is our understanding that subsection (c) of the bill is not intended to interfere with or restrict state action in extending

> total or partial exemption to property of any class, such as churches, charitable institutions, homesteads, and the like. (Senate Hearings, 1967, p. 82.)

Mr. Ogden also tried to clarify for the record the manner in which a comparison of assessment levels would be made between all other property and common carriers. According to Mr. Ogden, the bill contemplated a comparison of the relationship between a common carrier's property and that of the "average" taxpayer in the taxing district. Mr. Ogden went on to argue:

> [I]n order to make possible the fairest comparison -- that of the carrier with the hypothetical "average" taxpayer -- the unit to be used is that of all parcels of property in the district, considered in the aggregate. (Senate Hearings, 1967, p. 30.)

He went on to suggest that scientific proof of comparison assessment levels would be provided by a "sales/assessment ratio test". An expert witness for the railroads, Dr. Rolf Weil, later testified briefly on the feasibility of measuring discrimination using sales/assessment ratio studies and the ability of experts to apply "statistical weights" to arrive at realistic results where assessors had classified property. Dr. Weil believed that such comparative tests were both reliable and feasible. (Senate Hearings, 1967, p. 67.)

Opponents of the bill reiterated much of their testimony of the previous year. They also expanded upon earlier discussions relating to their belief that no objective standard existed that measured the relationship between assessment ratios for locally assessed property and centrally assessed property. In this testimony they were in direct opposition to Dr. Weil's contentions relating to sales/assessment ratio studies. (Senate Hearings, 1967, p. 112.)

In addition, the opponents stressed the need to examine the manner in which market values were established for various kinds of property. Mr. Charles Conlon, representing some 26 states, asked the Committee to consider the "great differences" in value between properties when various methods were employed in arriving at market value. (Senate Hearings, 1967, p. 89.) Conlon cited the work by Lynn A. Stiles, a former railroad assessor in the State of Illinois, who contended that the use of the unit appraisal rule in valuing railroads had the effect of giving such property de facto credit allowances in the normal course of assessment that were not generally available to other property. (Senate Hearings, 1967, p. 94.) Mr. Conlon explained:

> What he [Mr. Stiles] has in mind, if you have an ordinary factory, and you put a million dollars into the building and you have 2 or 3 bad years, you do not make any money, the local assessor still assesses that property on the basis that he would apply to any other. Whereas ... in the case of carriers, where you have what might be called this corporate deficit, this is in effect taken into account in coming to the appraised value of a railroad, and ... he concludes by saying these considerations would seem to merit recognition in any evaluation of the discrimination, and imperfection in the assessment equalization process are held to inflict on a rail carrier industry. (Senate Hearings, 1967, p. 94.)

Mr. Conlon attempted to raise other questions in the minds of the Senate committee members. Mr. Conlon said that in 1957 the Census of U.S. Government Statistics reported state assessments of railroad property to be $6.5 billion. In 1961, the figure was down to $5.9 billion. He stated that the figure for 1966 was around $6 billion. With the assessment figures established, he then pointed out that between 1957 and 1966 the U.S. Department of Commerce reported that railroad investment in new plant and equipment came to $13 billion. "In other words," Mr. Conlon said, "there has been

$13 billion new investment in plant and equipment this period, and yet the assessed values of that railroad property are lower than they were in 1956, before the $13 billion was put in." (Senate Hearings, 1967, p. 95.)

In 1968 the Senate Committee on Commerce recommended a "do pass as amended" for S. 927. Amendments to the bill specifically included motor contract carriers as well as motor common carriers within the bill's provisions and allowed a 3-year period of adjustment for state compliance. The full Senate took no action.

Hearings were held again in 1969 on S. 2289 with a resultant favorable report on the bill. The 1969 Senate Report noted three amendments placed on the bill as introduced. Transportation property was defined, the term "taxing district" was changed to "assessment jurisdiction", and a 5% tolerance factor on assessment variations was added. On the issue of "taxing district" versus "assessment jurisdiction", the Committee Report explained that there could be some confusion about what exactly was meant by either term. The Report went on to note that the "Committee believes that the resolution of that question is a function properly to be performed by a court upon considerations presented to it" on a case-by-case basis. (Senate Report, December 1969, p. 14.)

On January 30, 1970, the full Senate considered S. 927. A floor amendment exempted agricultural property and land used primarily in growing timber. The bill passed the Senate by a voice vote; it was heard in the House Committee on Interstate and Foreign Commerce but was not reported to the House floor.

The Senate again favorably reported a bill in 1972 that included amendments permitting states which classified transportation property in the same class as other utilities to apply the rate applicable to utilities to transportation property. The bill also exempted agricultural land from the definition of property. The bill did not pass the Senate. No other bill passed the Senate or the House until the enactment of Section 306 of the 4-R Act of 1976.

SUMMARY: LITIGATION AND ISSUES

The purpose of Section 306 of the 4-R Act is fairly clear. The Congress intended to "provide a plain, speedy, and effective remedy to eliminate discriminatory tax assessment and classification practices." (Senate Report, July, 1968, p. 7.) With that as the stated purpose of Section 306, it seems fair to ask why tax administrators and railroad officials have had to litigate the act in more than two dozen cases in the past 5 years.

Part of the answer lies in the difficulty of actually defining, documenting, and discouraging discrimination. Another part of the answer to the persistence of litigation is the limited, and often contradictory, guidance that the student of Section 306 can obtain from that section and its legislative history.

Section 306, and the legislative history behind the section, tend to assume discrimination but offer only general guidance on exact definitions. The section contains no magic formulas -- in fact, there are no formulas in the section at all. To compound the problem, the language of Section 306 was not the same language that was discussed in Senate and House hearings on previous 306-type legislation. As an example, the phrase "sales assessment ratio studies" never

appeared in any of the bills that either the Senate or the House considered between 1964 and 1972.

A current observer of tax litigation suits recently remarked, "I don't believe there is a tax administrator, whether representing a state or a utility, who looks forward to litigation." He went on to ask himself why, given the natural hesitancy to bring suits and the continued success railroads have had in obtaining relief under federal law, states were pursuing litigation under Section 306 of the 4-R Act. He answered his question this way:

> At first blush, it might appear that this is merely a delaying tactic on the part of these states that can only result in compounding the revenue problems of the taxing districts involved and reflects the stubbornness of the state officials who believe the Act should not be applied against them. Such a conclusion, however, is not justified. In a few cases, the decision to litigate may be based on political or economic considerations but more generally I believe that it is made because there are factual circumstances raising questions of interpretation of the 4-R Act which have not as yet been answered by the courts. (William F. Lahner, Jr., Recent Developments in Public Utility Tax Litigation, a paper delivered before the Twelfth Appraisal of Utilities and Railroad Property for Ad Valorem Taxation Program, Wichita State University, August 4, 1982, pp. 1-2.)

While the issues that have been raised have varied greatly, most seem to fall into four general categories*:

---

* For a discussion of all the available cases [to March 1984] that have dealt with Section 306 of the 4-R Act, see: "Federal Constraints on State Taxation of Railroad Property: A Report to the Revenue Oversight Committee", by Jim Oppedahl and J. Cort Harrington, Montana Legislative Council, Helena, Montana, March 1984.

1. challenges based on constitutional questions of federal jurisdiction in the area of state taxation;
2. challenges based on the definition of the "assessment jurisdiction";
3. challenges based on the definition of "commercial and industrial property"; and
4. challenges based on the statistical methodology that best compares the level of assessment between railroad property and commercial and industrial property.

CONCLUSION

The purpose of this chapter has been to survey the landscape of railroad taxation in Montana and the constraints of federal legislation passed by the Congress in 1976. Historically, Montana developed a taxation system that encompassed railroad property as part of the general taxation system and as part of the State's regulatory relationship with common carrier property.

For more than 100 years the relationship between the State (and Territory) and railroads regarding taxation was an internal one, sometimes heated, but more often than not on the back burner. Another element was added to the relationship in 1976 when the Congress declared that the state could no longer freely set taxation policy for railroad property.

If Section 306 of the 4-R Act continues to meet constitutional tests, the challenge to Montana policymakers regarding Section 306 is to design a state system of taxation for railroad property that meets federal standards.

APPENDICES

APPENDIX A

ASSESSMENT OF MONTANA RAILROADS
1920 to 1982

Year	Assessed Valuation	Assessed Valuation In Constant Dollars
1920	$ 237,486,482	$ 395,810,803
1921	236,523,954	441,276,034
1922	223,075,429	444,373,365
1923	235,419,066	460,702,673
1924	235,820,105	460,586,142
1925	231,723,828	441,378,720
1926	227,021,280	428,342,038
1927	227,521,792	437,541,908
1928	229,809,616	447,971,961
1929	232,683,958	453,574,967
1930	236,782,377	473,564,754
1931	233,743,313	512,594,985
1932	215,905,827	527,887,108
1933	183,250,713	472,295,652
1934	181,204,048	451,880,419
1935	180,808,609	439,923,623
1936	173,992,056	419,257,966
1937	173,831,763	404,259,914
1938	165,835,155	392,974,301
1939	159,975,292	384,555,990
1940	160,014,961	380,988,002
1941	159,893,230	362,569,683
1942	159,911,668	327,687,844
1943	167,182,341	322,745,832
1944	174,523,812	331,164,729
1945	175,235,604	325,112,438
1946	177,576,828	303,550,133
1947	178,444,573	266,733,293
1948	182,129,571	252,606,895
1949	187,612,296	262,762,319
1950	186,859,986	259,167,803
1951	187,630,303	241,170,055
1952	187,975,895	236,447,667
1953	187,186,865	233,691,467
1954	187,018,745	232,321,422
1955	185,548,471	231,357,196
1956	185,448,940	227,873,391
1957	185,892,328	220,619,606
1958	183,004,223	211,321,274
1959	168,276,722	192,756,841

Year	Assessed Valuation	Assessed Valuation In Constant Dollars
1960	$ 165,447,689	$ 186,525,016
1961	161,326,858	180,052,297
1962	146,515,768	161,717,183
1963	140,425,641	153,135,923
1964	133,185,490	143,364,360
1965	130,862,930	138,479,291
1966	133,807,462	137,661,998
1967	136,762,704	136,762,704
1968	124,706,855	119,680,283
1969	125,113,459	113,946,684
1970	114,201,400	98,195,529
1971	112,133,689	92,443,272
1972	112,130,548	89,489,663
1973	110,607,250	83,100,864
1974	108,909,606	73,737,039
1975	94,994,302	58,929,468
1976	95,924,913	56,260,946
1977	104,140,790	57,377,846
1978	102,970,053	52,724,041
1979	108,647,406	49,906,939
1980	116,113,203	47,009,394
1981	144,116,895	52,925,779
1982	168,658,704	58,440,299

Source: Reports of the Board of Equalization, Department of Revenue, 1920-1982. The 1978 to 1982 data is adjusted for comparability purposes due to a Legislative change in the property tax system in 1977. The constant dollar adjustments are made using the CPI for Urban Wage Earners and Clerical Workers. (1967 = 100)

JO:rm:CLASII:Assessments of Mt Railroads
March 8, 1984

APPENDIX B: BURLINGTON NORTHERN: Valuations: 1989-1983

BURLINGTON NORTHERN (000's)

	1979	1980	1981	1982	1983
Cost Indicator					
Dep Plant Owned	2,649,406	2,784,852	3,374,733	3,689,804	3,832,506
Dep Plant Leased	377,647	470,188	721,842	718,807	735,962
Materials & Supplies	211,829	268,062	359,218	282,925	256,491
Adjustment	-775,942	-851,478	-637,481	-1,586,616	-1,165,472
Total	2,462,940	2,671,624	3,818,312	3,104,920	3,659,487
Income Indicator					
Avg Income	69,379	91,715	184,926	205,057	214,289
Cap Rate	11.50	12.50	14.00	15.00	13.50
Capitalized Income	603,297	733,726	1,320,900	1,367,047	1,587,322
Market Indicator					
Stock	609,241	805,286	1,844,762	2,184,358	1,832,200
Debt	904,707	907,438	1,134,765	1,015,510	1,019,773
Current & Other Liab	661,506	735,251	987,860	1,359,951	1,552,133
Deductible Assets	-962,749	-1,182,637	-1,502,240	-2,642,205	-2,394,112
Total	1,212,705	1,265,338	2,465,147	1,917,614	2,009,994
Weighting	35/35/30	35/35/30	35/35/30	10/50/40	10/50/40
Conclusion of Value	1,436,994	1,571,474	2,538,268	1,788,332	1,963,608
CWIP	54,109	71,564	81,322	27,762	15,532
Allocation %	15.52	15.46	13.22	13.41	12.57
MT Allocated Value	231,419	254,014	346,310	243,538	248,778
Equalization 61%				148,558	151,754

AGREEMENT

The parties to this agreement, the Burlington Northern Railroad (BN) and the Montana Department of Revenue (DOR) have, by previous agreement settling lawsuits before the federal district court for Montana (numbers CV-80-139 BLG, CV-81-222-BLG, CV-82-226-BLG) agreed to negotiate in an attempt to resolve issues which might arise for calendar years 1983, 1984 and 1985 regarding the ad valorem taxation of the BN under both Montana's statutory tax system and Section 306 of the Railroad Revitalization and Regulatory Reform Act (49 U.S.C. § 11503) (4-R Act). Pursuant to that agreement negotiations were conducted by the parties. As a result of those negotiations, the parties agree that for the years 1983 through 1985 ad valorem taxes to be paid by BN will be determined on the following basis.

VALUATION

For each year beginning in 1983 and continuing through 1985 the DOR will value the BN for ad valorem tax purposes using the system of valuation which is commonly referred to as the unit valuation method. The DOR will compute value under this system by using three approaches. They are: (1) the cost approach, (2) the income approach, and (3) the stock and debt approach.

The detailed methodology utilized by the DOR shall be as set forth in the accompanying worksheets which are incorporated by reference. It is understood and agreed that BN shall at it's own expense annually obtain the opinion of New York investment bankers, Lehman Brothers Kuhn Loeb, as to the value of Burlington Northern, Inc. stock which is attributable to non-railroad activities of the company. The DOR will use such opinion in determining the non-operating property deduction under the stock and debt approach. If BN should wish to utilize the services of a different investment banker then an investment banker satisfactory to the DOR will be chosen.

II

EQUALIZATION

Once the valuation of BN has been determined as set forth above and BN's taxable value in Montana has been computed utilizing the statutory 15% classification rate, such taxable value shall be reduced by no less than the following percentages in order to reflect equalization relief:

1983	39%
1984	44%
1985	49%

For the 1983 tax year the equalization percentage set forth above shall be unadjusted.

The "Survey of Current Business," published by the Bureau of Economic Analysis, U.S. Department of Commerce contains an index of Personal Consumption Expenditures by Major Type of Product expressed in current dollars. If the annual percentage change in the Transportation category of that index between 1982 and 1983 exceeds 5%, then the amount by which BN's taxable value shall be reduced for 1984 shall be increased by the amount of such excess, but in no event shall BN be entitled to a reduction in taxable value which exdeeds 49% for 1984.

Similarly, if the annual percentage change in the Transportation category of that index between 1983 and 1984 exceeds 5% then the amount by which BN's taxable value shall be reduced for 1985 shall be increased by the amount of such excess, but in no event shall BN be entitled to a reduction in taxable value which exceeds 54% for 1985.

III

OTHER MATTERS

It is the ultimate goal of both the DOR and BN that BN be fairly taxed in Montana. Toward achieving that goal and in order to obviate the necessity for future litigation which may arise under Section 306 of the 4-R Act the parties agree to present to the Montana Legislature the following recommendation:

a. That the Legislature set up an interim study committee to study the solution to problems raised by equalization and classification questions in general and the problems raised by acts like Section 306 of the 4-R Act.

If the interim study does not address matters concerning the conducting of future sales assessment ratio studies in Montana and implementation of a personal property audit program the Department will recommend to the 1985 Legislature:

a. That the Department of Revenue be authorized to implement a personal property audit program. This "audit" program could be based upon the program implemented and used by the State of Washington.

b. That the Legislature implement procedures to conduct a sales assessment ratio study in the State of Montana beginning in 1986.

Consistent with the settlement agreement reached in lawsuits between the BN and DOR in U.S. District Court for Montana (numbers CV-80-139 BLG, CV-81-222-BLG, CV-82-226-BLG) and in light of this settlement for tax years 1983 through 1985, the DOR agrees to recommend to appropriate legislative officials that House Bills No's 62 and 86 presently pending before the 1983 Montana Legislature be withdrawn.

So long as the terms of this agreement are fulfilled, BN agrees that for years 1983, 1984 and 1985

it will make no challenges under Section 306 of the 4-R Act with respect to valuation, classification or equalization of its property for ad valorem tax purposes.

DATED this 10th day of February. 1983.

BURLINGTON NORTHERN RAILWAY COMPANY

By: _____
STEVEN L. WOOD
Assistant Vice President
State and Local Taxes
Burlington Northern, Inc.

MONTANA STATE DEPARTMENT OF REVENUE

By: _____
GREGG GROEPPER, Administrator
Property Assessment Division

VALUATION OF
BURLINGTON NORTHERN RAILROAD
FOR THE YEAR ENDING DECEMBER 31, 1981

Cost	$ 310,000
Income	683,524
Market	767,046
CWIP	27,762
	1,788,332

COST INDICATOR

(All amounts in 000's)

1.	Depreciated Plant Owned	$ 3,689,804
2.	Depreciated Plant Leased	718,807
3.	Materials & Supplies	282,925
4.	Adjustment for Obsolescence	(1,586,616)
5.	Total	3,104,000
6.	Weighting	x.10
7.	Cost Indicator	310,000

SOURCES

1. Depreciated Plant Owned

Page 36, Line 33, R-1 BN-CS	2,971,283	Road
Line 41, R-1 BN-CS	1,993,401	Equipment
Line 42, R-1 BN-CS	2,655	Other
Line 43, R-1 BN-CS	489	Other
Line 44, R-1 BN-CS	3,174	Other
Line 46, R-1 BN-CS	142	Other
	4,971,144	
Page 40, Line 28, R-1 BN-CS	(534,923)	Depr./Amort.
Page 40, Line 36, R-1 BN-CS	(746,417)	Depr./Amort.
	3,689,804	

2. Depreciated Plant Leased

CS 0325.2 Leased from Others	743,165	Depr. Cost
CS 0325.3 Leased to Others	(13,358)	Depr. Cost
	718,807	

3. Materials and Supplies

Page 5, Line 11, R-1 BN-CS	282,925

4. Adjustment for Obsolescence

3,689,804 x 43% =	1,586,616

The obsolescence factor will be determined by averaging the Blue Chip figures for the BLE, CNOTP and UP railroads in comparison with the B.N. Railroad.

INCOME INDICATOR

(All amounts in 000's)

	1980 (1)		1981 (2)
Net Income	210,437		199,676
Average		205,057	
Cap Rate *		15%	
		1,367,047	
Weighting		.5	
Income Indicator		683,524	
1. Page 20, Line 67, R-1 BN		172,831	
Page 10, Line 67, R-1 SLSF		37,606	
		210,437	
2. Page 10, Line 67, R-1 BN		195,285	
Page 10, Line 67, R-1 CS		4,391	
		199,676	

* The 15% capitalization rate was derived by a standard band of investment calculation utilizing a 67% equity portion and a 33% percent debt portion as the capital structure. The appropriate equity rate was derived by an analysis of earnings price ratios for the following companies: Southwestern, Southern Pacific, Kansas City Southern Ind., Missouri-Pacific Corp., Seaboard Coastline, Southern Railway, Norfolk and Western, Burlington Northern, Union Pacific Corp., Soo Line, Rio Grande Industries, Santa Fe Industries.

Rates of return were developed by dividing annual earnings per share of common stock by the annual average of monthly high and low common stock prices. The average prices per share of common stock were computed from quotations obtained from the "Bank and Quotation Stock Quote Reporter Service," and "The Wall Street Journal." The rates of return for the period were computed by dividing actual annual earnings per share for 1981 by the average of the high and low common stock prices for the year 1981. Earnings per share for 1981 were obtained from "Standard and Poor's Stock Guide" and "Standard NYSE Stock Reports."

The debt portion of the capitalization rate was determined by an analysis of current interest rates on equipment trust certificates and corporate bonds.

MARKET INDICATOR

(All amounts in 000's)

1.	Stock	$ 2,184,358
2.	Debt	1,015,510
3.	Current - Other Liabilities	1,359,951
4.	Value Non-Operating Assets	(1,574,000)
5.	Deductible Assets	(1,068,205)
	Total	1,917,614
	Weighting	x .4
	Market Indicator	767,046

SOURCES

1. Stock — 2,184,358
   (12 Month Average from Bank & Quotation Journal)

2. Debt

CS 308.3	Mortgage Bonds	387,627	
	Miscl. Obligations	32,827	
	Conditional Sales	253,394	
	Equipment Obligations	253,123	
	Capitalized Leases	67,764	
Page 6, Line 40, R-1 BN-CS		20,775	A/P Affiliated Co's
		1,015,510	

3. Current and Other Liabilities

Page 6, Line 35, R-1 BN-CS	984,718	Current Liabilities
Page 6, Line 34, R-1 BN-CS	(113,024)	L-T Debt due 1 Yr.
Page 6, Line 45, R-1 BN-CS (50%)	96,759	Other Deferred
Page 6, Line 44, R-1 BN-CS	391,498	Deferred ITC
	1,359,951	

4. Deductible Assets

Page 5, Line 13, R-1 BN-CS	1,258,712	Current Assets
Page 5, Line 11, R-1 BN-CS	(282,926)	Mater'l.& Supplies
Page 5, Line 14, R-1 BN-CS	38,816	Special Funds
Page 5, Line 17, R-1 BN-CS (.50)	13,247	Other Assets
Page 5, Line 18, R-1 BN-CS (.50)	17,594	Other Deferred
Page 36, Line 47, R-1 BN-CS	27,762	CWIP
	1,068,205	

ALLOCATION WORKSHEET

	MONTANA	SYSTEM	%
Plant Depreciated	453,204,356	3,689,804,000	12.28
Revenue	588,703,559	3,903,477,160	15.08
Track Mileage	4,769.36	41,085.98	11.61
Revenue Ton Miles	24,762,620	165,562,232	14.96
Car & Locomotive Miles	647,017,629	4,923,629,914	13.14
		Average	13.41

CHAPTER THREE

INTRODUCTION

The first and second parts of this section briefly discuss both a general outline of property tax classification systems in other states and a general outline of legal challenges to such systems. The third part of the section outlines several states' legislative and administrative responses to 4-R Act type of legislation, referred to in the part as "federally protected property legislation".

PART I
CLASSIFICATION SYSTEMS IN THE UNITED STATES

By 1982 fourteen states and the District of Columbia had legalized general classified property tax systems. Minnesota, Montana, and West Virginia were the only states in the U.S. that had statutory property tax classification systems prior to the 1960s. Two states adopted classification systems during the 1960s. In the decade that followed, nine states and the District of Columbia passed laws to implement classification systems. Missouri may be the next state to adopt a property tax classification system, since its voters amended their Constitution in 1982 to allow the Legislature to adopt a three-class system.

In addition to the fourteen states and the District of Columbia, there are a number of states in which explicit authority exists for classification but where the authority has not been used. Kentucky, Maryland, North Carolina,

South Dakota, North Dakota, and Washington are examples of this.[1]

A number of reasons for the proliferation of classified property tax systems have been cited by observers. The primary pressures upon legislatures to adopt classification systems have been from a desire to: (1) respond to court decisions demanding equalization by legalizing de facto classification systems; (2) respond to inflation driven shifts in tax burdens; (3) influence land use decisions; (4) mitigate the impact on certain classes of taxpayers due to improvements in the quality of assessment administration; and (5) provide tax relief for certain classes.[2]

Individual states have had considerably different reasons for adopting classification systems. However, seven states -- South Carolina, Alabama, Arizona, Tennessee, Louisiana, Illinois, and Massachusetts -- have adopted property tax classification systems since 1968 apparently in order to legalize existing practices or because of court decisions demanding equalization.[3]

The District of Columbia, which has mostly residential and commercial property, little industrial property, and no agricultural property, adopted classification in order to deal with residential inflation that was double the rate of commercial property inflation. The purpose of classifying property for tax purposes in the District of Columbia was to give homeowners a break.[4]

In Hawaii, classification was adopted to stimulate vacant lot development. The classification system was phased out in Hawaii in 1980, although agricultural and residential property may still qualify for use-value assessments.[5]

Structurally, all of the classification systems in the U.S. fit into four general categories (see Table 1 on page 3-7):

(1) Constitution specifies classes but not rates or ratios.

(2) Constitution specifies classes and rates or ratios.

(3) Constitution permits classification but places various restrictions on the use of classification -- such as restrictions on areas that may classify, number of classes, relationship between classes, etc.

(4) Constitution permits classification and leaves the legislature with total discretion for establishing system.

Table 2, pages 3-8 through 3-11, presents a brief background that outlines the general nature of the classification movement in selected states. While not exhaustive, the outline provides concise examples of the general constitutional limits within several states and the nature of legislative responses to property tax pressures.

Finally, it should be noted that classification of property for taxation purposes is not the only method available to a Legislature to adjust the burdens of tax policy and the consequences of equalized assessments. Legislators in classified and nonclassified states alike have a variety of taxation alternatives that are modified forms of property classification. Examples of such alternatives include real and personal property tax exemptions, homestead exemptions or tax credits, circuit breakers or refunds for homeowners, use-value assessment or tax deferral for farmland, rollback taxes, and tax deferrals for certain other taxpayers.[6]

While there are only a handful of states that formally classify property, many states practice what amounts to selective classification. In 1979, for example, thirty-eight states and the District of Columbia had homestead exemption provisions, twenty-eight states employed residential circuit breakers, and forty-eight states valued agricultural land preferentially.[7]

PART II
GENERAL BASIS FOR LEGAL CHALLENGES OF CLASSIFIED PROPERTY TAX SYSTEMS

Legal challenges to classified property tax provisions are made on both the state and federal level. On the state level, challenges tend to be based on equal protection grounds and upon specific state constitutional or statutory provisions that require uniformity or equalization within classes. On the state level, the legal challenges vary greatly in detail and from state to state.

In Montana, the constitutionality of the classification system has been settled law since 1919 -- the year the legislature enacted a classification system. The Montana Supreme Court, in Hilger v. Moore (56 M 146, 182 P 477 (1919)), ruled that classification of property for taxation purposes did not infringe upon the guarantee of equal protection. This discussion will concentrate on the general nature of federal challenges to classification that could affect Montana.

Federal limitations on the right of a state to impose a tax are generally based on either the Commerce Clause or the Supremacy Clause of the United States Constitution.

Article I, section 8, clause 3, of the United States Constitution provides that Congress has the power to regulate commerce with foreign nations, and among the several states, and with Indian tribes. The U.S. Supreme Court has interpreted the Commerce Clause to prohibit a state from placing a burden on interstate commerce.

With respect to whether a state tax imposes a burden on interstate commerce the U.S. Supreme Court, in Complete Auto Transit, Inc. v. Brady, (430 U.S. 274 (1977)), has set forth a four-part test by which to judge a state tax. The test is comprised of the following questions:

(1) Does the tax apply to an activity with a substantial nexus in the the taxing state;

(2) Is the tax fairly apportioned;

(3) Does the tax discriminate against interstate commerce; and

(4) Is the tax fairly related to the services provided by the state.

An example of a tax that survived scrutiny under this four-part test is the Montana coal severance tax. In Commonwealth Edison v. Montana (453 U.S. 609 (1981)), one of the challenges to the coal severance tax was that it violated the Commerce Clause. It was conceded by all sides that the first two parts of the Complete Auto test were satisfied. In ruling that the third part of the test was satisfied, the Supreme Court found that the tax burden was determined by the amount of coal consumed and not according to any distinction between in-state and out-of-state consumers; therefore, the Court concluded that there was no discrimination against interstate commerce.

When addressing whether the tax is fairly related to the services provided by the state, the Court stated that states

have considerable latitude in imposing general revenue taxes. The only benefit to which a taxpayer is entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes.

Article VI, clause 2, of the United States Constitution provides:

> This constitution and the laws of the United States which shall be made in pursuance thereof, and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the constitution of laws of any state to the contrary notwithstanding.

The Supremacy Clause means, therefore, that a state tax that conflicts with a federal statute is preempted by the federal statute. Generally, state laws carry a presumption of validity; preemption of state law by federal statutes is not favored. Courts will not preempt state law without substantial cause to believe that the nature of a federal statute permits no other conclusion or that Congress has unmistakenly so ordained.

Referring again to the coal tax case, the U.S. Supreme Court said that Congress has the power to limit Montana's coal tax in furtherance of some public policy -- but that Congress had not done so. Therefore, Montana's coal severance tax does not violate the U.S. Constitution's Supremacy Clause. The above U.S. Constitutional provisions form the background against which the courts base decisions relating to state taxation systems.

TABLE 1

CHARACTERISTICS OF EXISTING CLASSIFICATION SYSTEMS

STATE	YEAR OF ADOPTION	RATE	PERCENT ASSESS/ VALUE	CLASSES SET BY CONSTITUTION	CLASSES SET BY LEGISLATURE	NUMBER OF CLASSES
ALABAMA	1972		X	X		4
ARIZONA	1968	X			X	7
HAWAII*	1961	X				
ILLINOIS (Cook Co. only)	1973		X	X		5
LOUISIANA	1978		X	X		3
MASSACHUSETTS	1978		X	X		4
MINNESOTA	1913		X		X	14+
MONTANA	1919		X		X	12
NEW YORK	1981	X			X	4
OHIO	1980	X		X		2
SOUTH CAROLINA	1976		X	X		7
TENNESSEE	1973		X	X		4
WASHINGTON D.C.	1979	X			X	3
WEST VIRGINIA	1934	X		X		4

* Hawaii technically phased out classification in 1980, but still maintains provisions for use-value assessments for residential and agricultural property.

Adapted from: Moore, chapter 7, table 12.

TABLE 2*

SELECTED PROPERTY TAX CLASSIFICATION STATES

ARIZONA: Adoption of a formal classification system was preceded by many years of frustration with the lack of assessment uniformity . The Arizona Constitution did not prohibit classification. A catalyst for adoption of a formal classification system came from a court decision (Southern Pacific Co., v. Cochise County, (1963)) in which attorneys for the Southern Pacific Railroad claimed that the railroad (centrally assessed) was assessed at a higher percentage of value than other property that was locally assessed. In response to the court case the Legislature began a program of statewide reappraisal.

When reappraisal was completed and average assessment levels were known, the Legislature adopted a legal classification system that attempted to mirror the de facto classification system in effect in 1966.

MASSACHUSETTS: Prior to 1978 the Massachusetts Constitution required uniformity of assessments across all classes of property. In the face of court requirements that property be assessed at full value and fears that such assessments would shift $180 million of additional taxes to residential property, attempts were made to enact a constitutional provision that would allow classification. While an early attempt failed, the classification provision was actually adopted in 1978.

* Source: Material is compiled from Moore, chapter 5, and Roemer, pp. 108-10.

NEW YORK: In response to a 1975 New York court case (Matter of Hellerstein v. Assessor, Town of Islip, (1975)) that required local assessors to value property at full value, the State Legislature mandated a revaluation of all property to be completed by January 1, 1981. The shift in taxation that resulted was toward residential property and would have more than doubled residential property taxes in New York City. The classification system in New York was adopted in order to deal with tax base shifts that would result from compliance with assessing at full value.

OHIO: In a series of cases beginning in 1962, commercial property owners began to challenge Ohio's assessment system as discriminatory against business. Shifts in tax burdens were also taking place because of uneven inflationary increases that raised average home values by 40% between 1974 and 1980. Required sexennial reappraisals provided a sense of urgency to the inflation pressures.

In 1980, a constitutional amendment that allowed classification was adopted by the people of Ohio.

TENNESSEE: Disparity in the assessment process in Tennessee led to several suits being filed in both state and federal courts by railroads operating in Tennessee. The plaintiff railroads claimed that railroad property (centrally assessed) was assessed at a higher percentage of market value than locally assessed property. Tennessee's Constitution contained a uniformity clause. Court decisions found that Tennessee had long had a de facto property tax system that violated the uniformity clause in its state Constitution.

As the State began to comply with court rulings by providing for the gradual improvement of assessments, the issue was

brought before a constitutional convention called specifically to deal with classification; the idea of classification received endorsement. The voters adopted a classification amendment to the Tennessee Constitution in 1972, (effective 1973).

WASHINGTON, D.C.: Inflationary increases between 1965 and 1975 for residential property that were more than twice the increase for commercial property led city officials to examine classification. The uneven increases, coupled with required annual reappraisal in the District, were rapidly shifting the relative tax burden from commercial to residential. Classification of property into a residential class and an "all other" class was intended to eliminate the inflationary disparity.

PART III

STATE LEGISLATIVE AND ADMINISTRATIVE RESPONSES TO FEDERAL PROTECTED PROPERTY LEGISLATION

According to Jim Oppedahl, former staff person to the Montana Legislature's Revenue Oversight Committee, the idea of prohibiting discriminatory taxation of railroads had been around long before the enactment of the Railroad Revitalization and Regulatory Reform Act of 1976, and in fact, "allegations of discriminatory taxation of railroads began as early as 1944."[8] A 1944 report to Congress expressed the railroad taxation situation in the following manner:

> The officials of approximately half the States readily concede that railroads are being overtaxed because of inadequate equalization. . . . If we accept the standards of equity set forth in the present tax laws, this failure to equalize State and local assessments is probably the most significant of the railroad tax grievances.[9]

The implications of the 1944 report and the 4-R Act are clearly that states' tax policies are adversely affecting railroads. A further implication of the Act is that the states have the ability to establish equitable treatment of all commercial and industrial property for tax purposes, and only in instances where a state fails to achieve equitable treatment will the federal government intervene.

STATE RESPONSES TO FEDERAL PROTECTED PROPERTY LEGISLATION

Although the 4-R Act was adopted in 1976, it did not become effective until February 1979. States that had purportedly been discriminating against the railroads, were required to bring their respective tax systems into compliance with the Act. However, rather than making decisions on their own, many Legislatures were apparently willing to rely on direction from the judiciary .*

Some states, like Montana, have been sued but reached out of court settlements. A survey of 11 states shows that the most common action taken by states from the effective date of the 4-R Act (1979) to the present (other than reliance on the courts) has been administrative action. Table 3 summarizes the results of the survey.

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* Of the states surveyed, Arizona, California, Minnesota, North Dakota, and Wyoming have gone to court over equalization issues arising from the 4-R Act. The other states have all been involved in valuation cases in state courts, with the exception of Washington, where Joe Simmonds, a Department of Revenue official, said, "We've had no problems with the 4-R Act."

TABLE 3

STATE RESPONSES TO THE 4-R ACT

State	Valuation Method	Legislative Response	Administrative Response	Personal Property
Arizona	Unitary	Yes	Yes	Taxable
California	Unitary	No	Yes	Taxable
Idaho	Unitary	No	Yes	Taxable
Minnesota	Unitary	Yes	Yes	Exempt
Montana	Unitary	No	Yes	Taxable
New Mexico	Unitary	No	Yes	Taxable
North Dakota	Unitary	No	Yes	Exempt
Oregon	Unitary	No	No	Taxable
South Dakota	Unitary	No	Yes	Exempt
Washington	Unitary	No	Yes	Taxable
Wyoming	Unitary	No	Yes	Taxable

SOURCE: Compiled by Montana Legislative Revenue Oversight Committee staff, telephone survey conducted by Dave Bohyer, August 29, 1984, to September 14, 1984.

Direct Legislative Responses

Of the states surveyed, Arizona was the first - and one of only two states - to react legislatively to the 4-R Act. In 1980 the Arizona Legislature amended the State's tax statutes to include a separate class of property for railroads and private car companies. The legislation also established the method for determining the ratio at which railroad property is assessed.[10] (See: Appendix A, in "State Legislative and Administrative Responses to Federal Protected Property Legislation" by David D. Bohyer, Montana Legislative Council, Helena, MT, September 1984. Hereinafter cited as "Bohyer".)

In 1984 the Minnesota Legislature revised statutory language by granting broad discretion to the Minnesota Tax Commission to value railroad property according to "generally accepted

appraisal principles and practices which may included the unit method."[11] Even given this broad discretion, the Tax Commission is currently using the unitary method.[12] (See Bohyer, Appendix B.)

Indirect Legislative Responses

The Idaho Legislature adopted legislation in 1980 requiring all property to be assessed at 100% of market value. According to Charles McCreath with the Idaho Tax Commission, prior to 1980 the statutory assessment level had been 20% of market value, the actual statutory assessment level varied so much that any estimate would be inaccurate.[13]

In 1984 the New Mexico Legislature appointed an interim study committee to examine property taxation in New Mexico. Gloria Trujillo, the study committee's staff person, reported that concerns about the railroads had surfaced in committee discussions, but the committee had not specifically addressed railroad taxation concerns before September of 1984.[14] (See Bohyer, Appendix C.)

The North Dakota Legislature adopted legislation in 1983 setting the assessment level for all commercial and industrial property at 10% of market value. (See Bohyer, Appendix D.) Residential property assessments were to be 9% of market value. The legislation resulted from the decision rendered in Soo Line Railroad Company v. North Dakota (286 NW2d 459 (1979)), and not directly from the 4-R Act. However, the Soo Line case was an equalization case filed as a result of the 4-R Act.[15]

The Oregon Legislature, in 1984, established the assessment level for all property at 9.6%. The Legislature also separated residential property from other types of property.[16]

Administrative Responses

The California Board of Equalization, without any state legislative mandate, instituted the practice of developing sales/assessment (S/A) ratios for commercial and industrial property shortly after the enactment of the 4-R Act.[17] In the early 1980's, the Board also abandoned a valuation practice called "betterment accounting".[18] As described by John Nicolay of the Montana Department of Revenue, this accounting practice considers any cost in excess of replacement cost as an increase in the value of the asset. For example, if a railroad replaces 80 pound track with 120 pound track, the difference in the value between the 80 pound track and the 120 pound track would be accounted for as an increase in the value of a capital asset (the track), rather than as an expense.

In August of 1984, the Idaho Tax Commission was considering revising its method of applying the cost approach to unit valuation by applying "reproduction cost less depreciation" instead of "historical cost less depreciation". The Commission would not take any final action until the revision was fully researched.[19]

By 1984, the Minnesota Department of Revenue had implemented the previously mentioned legislative changes by revising its rules relating to railroad assessment. The rules changes included the methods by which the unit value would be determined, the method for determining the capitalization rate necessary to employ the net income method of valuation, the means of calculating obsolescence, and the way in which equalization would be determined through the development of S/A ratios.[20] (See Bohyer, Appendix E.)

To comply with the 4-R Act, the New Mexico Department of Taxation and Revenue applies an S/A ratio to railroad

property. The ratio currently used is based upon sales and assessments of residential property, but the Department intends to develop a commercial/industrial ratio for 1985.[21]

North Dakota completed a reappraisal of all taxable property in mid-1984 as a result of the decision in Soo Line. Mary Dickerson, an appraiser with the North Dakota Tax Commission, also said that commercial/industrial S/A ratios were developed as a result of the same case.[22]

Oregon, while using the unit method of appraisal for railroads and some other types of interstate industrial property, began to rely on the income approach almost exclusively in 1984. The income approach used in Oregon determines the value of railroad property based on a 19-year estimated life using (for 1984) a capitalization rate of 14%.[23]

In August of 1984, the South Dakota Department of Revenue was in the process of "removing the influence of personal property from railroad assessments." Assessments in each county in South Dakota were equalized to the ratio of all other property in the county.[24]

The Department of Revenue in Washington State calculates S/A ratios for both real and personal property. The appropriate ratio is then applied to each type of property to arrive at a total assessed value.[25]

The Wyoming Department of Revenue changed its capitalization rate for use in the income approach in 1984. The rate used in Wyoming (after the changes) reflects an "after tax capitalization rate" where before a "before tax" rate was used. For 1984, the "after tax" rate was set at 11.5%. According to an official with the Wyoming Tax Commission, the State in 1984 no longer relied on the cost approach as an indicator of value.[26]

SUMMARY

Through 1984, legislative responses to the 4-R Act appeared to be rare among the states. In Arizona and Minnesota, where legislation was implemented as a direct response to the 4-R Act, the states' statutory provisions added little to the federal provisions. Two other states, Montana and New Mexico, had legislative committees examining property tax issues. None of the other states surveyed had or foresaw any legislative response.

In addition, neither the National Conference of State Legislatures nor the Council of State Governments had compiled any information on states' reactions to federal protected property legislation. The organizations were not aware of any state studying the issue.[27]

Research conducted for this report indicated that the typical responses to the 4-R Act of the states surveyed were changes in the administration of property tax statues, both state and federal. Of the 11 states examined, all of them employed the unit method of appraisal and only two did not conduct S/A ratio studies on a regular basis. Most of the states developed S/A ratios for commercial and industrial property and for residential property. Some states also developed separate ratios for real and personal property. The commercial/industrial ratios are, of course, a requirement under the 4-R Act. Real property/personal property ratios may also be required under the Act.

Because all 11 states surveyed utilized the unit method of appraisal and nine of the states regularly calculate and apply S/A ratios to railroad property, options available to the states for maintaining their property tax bases seemed to be limited. This may still be the case. However, how the states calculate the unit value can have a considerable

effect on the railroads' taxable value and on the states' tax bases.

One additional item of considerable importance to this discussion is that the federal courts have been most reluctant to review valuation under the 4R Act's provisions. In an August 1984 memorandum to the Revenue Oversight Committee, Cort Harrington, Montana Legislative Council staff attorney, reported that:

> . . . federal courts have jurisdiction to determine valuation issues under section 306 only where a railroad can make "a strong claim showing of a purposeful over-valuation of a particular railroad's property with discriminatory intent." Congress, in enacting section 306, was concerned primarily with equalization, not valuation.[28]

Perhaps because of Congressional intent focusing on equalization and the federal judiciary's apparent reluctance to review valuation issues, states by mid-1984 had begun to revise methods of determining the actual full market value of railroad property. Whether through the abandonment of "betterment accounting" as in California, a heavily weighted reliance on one approach to valuation as is the case in Oregon (income approach) and Idaho (reproduction cost less depreciation), or whatever, states are beginning to devise methods for assuring that 100% of the railroad's value is accounted for.

Consequently, while the equalization element of taxation is not open to adjustment under the 4-R Act, the valuation element appears to be. Revising methods for determining and assuring the full market value of railroad property appears to be an easily understandable, workable, and legally acceptable option open to the states.

END NOTES

[1] Margaret D. Moore, "Property Tax Classification of Real Estate: Trends, Cause and Fiscal Consequences", draft copy, unpublished Ph.D. dissertation submitted to Ohio State University in 1982, various paginations, chapter 5 (hereinafter cited as Moore); Classified Property Tax Systems in the U.S., International Association of Assessing Officers, (Chicago, Ill.: 1979), p 1.

[2] Arthur C. Roemer, "Classification of Property", p. 108-9, in C. Lowell Harriss, ed., The Property Tax and Local Finance (Capital City Press, Montpelier, Vt: 1983) (hereinafter cited as Roemer).

[3] Moore, chapter 5 ; "Classified Property Tax System, Fiscal Notes, Office of Planning and Research, Comptroller of Public Accounts, State of Texas, June 1980, p. 10.).

[4] Ibid.

[5] Ibid.

[6] Roemer, p. 110-12.

[7] Steven D. Gold, Property Tax Relief (Cambridge, Mass.: Lexington Books, 1979), p. 15.

[8] Jim Oppedahl and J. Cort Harrington, Jr., "Federal Constraints on State Taxation of Railroads", Montana Legislative Council, March 1984.

[9] Letter from Board of Investigation and Research transmitting a Report on Carrier Transportation, House Document No. 160, 79th Congress, September 19, 1944, as cited in Oppedahl, "Federal Constraints on State Taxation of Railroads."

[10] David Thomas, Arizona Legislative Research Services, telephone interview, September 5, 1984. Also, Bill Nowlin, Arizona Department of Revenue, telephone interview, September 7, 1984.

[11] Chapter 502, Article 9, Laws of Minnesota, 1984.

[12] Wayne Gerwing, Minnesota Tax Commission, telephone interview, September 6, 1984.

[13] Charles McCreath, Idaho Tax Commission, telephone interview, September 10, 1984.

[14] Gloria Trujillo, New Mexico Legislative Council, telephone interview, September 6, 1984.

[15] Mary Dickerson, North Dakota State Tax Commission, telephone interview, August 29, 1984.

[16] Dick Green, Oregon Department of Revenue, telephone interview, September 9, 1984.

[17] Harold Hale, California State Board of Equalization, telephone interview, September 5, 1984.

[18] Robert Gustafson, California Board of Equalization, telephone interview, August 30, 1984.

[19] McCreath.

[20] Gerwing.

[21] Trujillo.

[22] Dickerson.

[23] Green.

[24] Dennis Hanson, South Dakota Department of Revenue, telephone interview, September 6, 1984. As indicated in Table 1, South Dakota exempts personal property.

[25] Joe Simmonds, Washington Department of Revenue, telephone interview, September 10, 1984.

[26] Warren Bower, Wyoming State Tax Commission, telephone interview, September 5, 1984.

[27] The information included below is treated in a footnote because including it in the narrative portion of this part would not provide any additional information on the issue, i.e. states' responses. Neither organization was aware of any state response.

STATE RESPONSES IDENTIFIED BY NATIONAL ORGANIZATIONS

National Conference of State Legislatures

The National Conference of State Legislatures has apparently not tracked the railroad taxation issue. There are no NCSL reports on railroad taxation, nor is there a staff person assigned to railroad taxation or to property taxation generally. A referral from NCSL to the Railroad Task Force, a subcommittee of the American Association of State Highway Officials, resulted in another dead end. Neither the AASHO nor the subcommittee has addressed the issue. (Cathy Brennan-Wiggins, NCSL, Washington, D.C., telephone interview, September 7, 1984. Also, Bill Druhan, AASHO Railroad Task Force, Washington, D.C., telephone interview, September 7, 1984.)

Council of State Governments

The Council of State Governments prepared and published State Taxation of Railroads and Tax Relief Programs in 1977. This hundred-odd page book addressed the situation facing the nations' railroads in the mid-1970's, pointed up the fact that eight northeastern and midwestern railroads failed during the early 1970's, and outlined alternatives available to the states for assisting the rail industry. The alternatives listed in the report included such measures as exemption of railroad property from state property taxation, a reduction in the level of assessment for railroad property, a reduction of the tax rate applied to railroad property, tax credits which could be earned for certain investments in railroad operations, and tax deferral programs. In addition, several options for easing railroad tax burdens resulting from income taxes, sales and use taxes, and capital stock taxes were also listed. The report concludes by outlining measures available to states for granting aid to the railroads through state investment in main lines, branch and secondary lines, and rail terminals. (James F. Runke and Alan E. Finder, State Taxation of Railroads and Tax Relief Programs, Council of State Governments, Lexington, Kentucky, November, 1977.)

Staff at the CSG's Lexington, Kentucky, office could not identify any other reports on railroad taxation done by CSG staff, nor were they aware of any state reports on the issue.

[28] J. Cort Harrington, Memorandum to the Revenue Oversight Committee, August 23, 1983, Montana Legislative Council.

CHAPTER FOUR

RAILROAD AND UTILITY VALUATION AND OPTIONS FOR COMPLYING WITH FEDERAL LEGISLATION

Introduction

Since the Railroad Revitalization and Regulatory Reform Act was passed by Congress in 1976, states' options in taxing railroad transportation property have been restricted considerably.* The provisions of the 4-R Act are restrictive in that any state or local assessment or tax rate that is higher for railroad transportation property than the assessment or tax rate on all other commercial and industrial property in the same tax jurisdiction as the railroad property is prohibited. Consequently, states are required to bring their respective tax systems relative to railroads into compliance with the 4-R Act.

The issue addressed in this chapter is the identification of options for achieving the required compliance, not only for railroad transportation property, but for all property protected by federal law. The issues are addressed by reviewing the requirements of the 4-R Act, examining how "value" for tax purposes is established under the unit method of appraisal, and, finally, examining how Montana's property tax system and the 4-R Act can be reconciled.

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* The same is true of other types of transportation property, including airlines and motor carriers. Since the provisions of federal law prohibiting tax discrimination by states is essentially the same for all three types of transportation property, references to tax implications to

Requirements Under Section 306 of the 4-R Act

The language of the 4-R Act most relevant to this discussion is contained in Section 306 of the Act. In part, the provisions of Section 306 state:

> (1) Notwithstanding the provisions of section 202(b), any action described in this subsection is declared to constitute an unreasonable and unjust discrimination against, and an undue burden on, interstate commerce. It is unlawful for a State, a political subdivision of a State, or a governmental entity or person acting on behalf of such State or subdivision to commit any of the following prohibited acts:
>
> (a) The assessment (but only to the extent of any portion based on excessive values as hereinafter described), for purposes of a property tax levied by any taxing district, of transportation property at a value which bears a higher ratio to the true market value of such transportation property than the ratio which the assessed value of all other commercial and industrial property in the same assessment jurisdiction bears to the true market value of all such other commercial and industrial property.
>
> (b) The levy or collection of any tax on an assessment which is unlawful under subdivision (a).
>
> (c) The levy or collection of any ad valorem property tax on transportation property at a tax rate higher than the tax rate generally applicable to commercial and industrial property in the same assessment jurisdiction.
>
> (d) The imposition of any other tax which results in discriminatory treatment of a common carrier by railroad subject to this part.

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railroad transportation property are similar to the other types of transportation property as well. For convenience, the three types of property are "lumped" into one category, which is often referred to in this report as "federally protected property" or "protected property". (See Appendices A and B.)

In order for states to comply with these provisions, each state must determine:

1) the true market value of railroad transportation property;

2) the level of assessment for railroad transportation property;

3) the true market value of all other commercial and industrial property;

4) the level of assessment for all other commercial and industrial property;

5) the ratio of the assessed value of railroad transportation property to the true market value of the property; and

6) the ratio of the assessed value of all other commercial and industrial property to the true market value of all other commercial and industrial property.

Once the above data are compiled, each state, assuming the state is the responsible taxing jurisdiction, must ensure that the value described in item number 5 above does not exceed the value described in item 6. If the item 5 value does exceed the item 6 value, the state is in violation of the 4-R Act.

Under this formula, the state's responsibility is fairly well clarified. The state must accurately measure the true market value of all commercial and industrial property, including railroads, and subsequently determine at what percentage of true market value such property is assessed. However, a real problem may arise in some instances in determining the "true market value".

Valuation of Utility and Railroad Property

Disagreements arise from many quarters as to the true market value of railroad property, principally because of the fact

that railroads as separate entities do not change ownership very frequently. For this reason, a commonly accepted and easily understood method of appraisal based on comparable sales is not available. Consequently, estimates of true market value using other more technical methods must be made.

There are several methods of valuing railroad property, as well as other types of industrial and utility property. However, none of the methods has universal acceptance by all interested parties. While somewhat lengthy, the following quotation from a report by the Western Association of Tax Administrators is quite instructive.

> Prior to discussing the several approaches to value (cost, income, and stock and debt), a few comments are appropriate on market value and on unit valuations. In the laws of most, if not all, states, there is a definition of value for property tax purposes. The descriptive words may be full cash value, actual cash value, true cash value, fair cash value, or market value. Without involving ourselves in the niceties of words, it is assumed that all of these values contemplate a value equivalent to a transaction where a willing buyer and a willing seller exist, where both parties are knowledgeable, where there is no undue pressure or force to buy or sell, where reasonable time exists for exposure of the properties to the market and where negotiations are at arm's-length.
>
> The natural comment from the critic or the intent student of central assessment is that since the properties sell so infrequently, there is never established a market value bench mark. This is true and it is also true of certain properties other than railroads and utilities. The mere fact that sales are lacking does not preclude the appraiser from attempting to estimate a value at the defined market value level. It becomes a real challenge to those in central assessment appraisals to find a theoretical market value. Because there are no sales, does not lead an appraiser to a salvage or scrap value concept. These would be appropriate only when salvage or scrapping was imminent. It does not mean valuing the properties under a different use unless a new use is in the offing. It does mean an estimate of a market value which a purchaser would pay

contemplating a similar use of the property as of assessment date.

Closely akin to market value is the use of the unit appraisal technique. The unit appraisal means valuing the total properties as "one thing." In contrast, the summation appraisal is valuing individual items as fractional items and then adding together the value of all the fractions to reach the total. Centrally assessed properties are usually thoroughly integrated in operation and construction. The value of a length of copper wire in an electric system lies not in the fact that copper has a market as scrap metal but that the wire is a part of a thoroughly complete and integrated electric system. An item in the complex array of many property items practically defies individual or segregated valuation. Segments of the total property can be valued by allocation or apportionment of the total unit value when required for statutory reasons even though allocation violates the basic theory of unit valuation. As the usual rule, however, no attempt is made to assign values in a unit appraisal to individual items of property unless it is a legal requirement. Standing apart, individual items of property possess some type of liquidation value; arranged together as a team of properties, the total property complex has a value invariably greater than the sum of many liquidation values for individual items. (Western Association, pp. 2-3.)

What is stated above, then, is that railroad property, like other utility property, is most reasonably valued for tax purposes as a unit and not as it might be broken into its separate parts. In addition, a reasonable approximation of true market value can be ascertained by any of several methods, even without numerous market sales for verification.

The three most commonly used methods for valuing railroad property are the cost approach, the income approach, and the stock and debt approach. Unquestionably, each method has its strengths and weaknesses as well as its supporters and detractors.

Cost Approach

The cost approach to market value suggests that the cost of the property, depreciated, will approximate the market value of the property. While the theory of the cost approach may be economically sound, there are several items deserving attention when using this approach.

The first of these items is the proper "cost" to assign to a property being valued. There are basically five types of cost indicators.

1) historical -- cost when first put in service;
2) original -- the cost of a property to the present owner;
3) book value -- the original cost less accrued depreciation;
4) reproduction -- present cost to replicate the property; and
5) replacement -- present cost to replace the property with a functional equivalent.

There are cases in which there is no difference between the various costs. With new property, for example, original cost and book value are the same, and are likely indicative of market value. However, circumstances are rare that an entire property would have equal original cost and book value due to the effects of depreciation on the property over time. Hence, the cost of the property must be devalued to allow for depreciation.

Depreciation itself deserves some attention because of its effect on a property's value, i.e. reduction in value over time. Depreciation is represented by three different factors resulting in reduced value.

The first of these factors is physical deterioration, generally a result of the normal aging process, including action of the elements.

The second factor is functional obsolescence. This type of depreciation is a loss in value because of functional deficiencies or inadequacies within the property itself. Technological changes are often the cause of functional obsolescence.

The third factor is economic obsolescence. This type of depreciation results in a loss in value caused by factors outside the property itself. Regulation of earnings and the base upon which earnings are founded are often cited as examples of economic obsolescence.

Regardless of the method of depreciation used in valuing property under the cost approach, each of the depreciation factors must be accounted for.

Rate Base Cost Approach vs. Market Value Cost Approach

Because utility property commonly has as its rate base the book value, appraisers often hear the argument that the same value is market value for tax purposes. This argument is addressed directly in the Western Association of Tax Administrators (WATA) report on railroad and utility valuation.

> By coincidence book value and market value may be the same but basically they are different in theory. Rate base is a statistic, not a valuation, let alone a market valuation. If rate base were adopted as market value, it would be unmoved by inflation and depression, by adverse earnings, by varying costs of money and the whole market environment. Secondly, rate base is a reference point or datum plane to measure performance. For illustration, if earnings are allowed at a certain level, it is not determined always by a percent times a rate base. In most cases a level of earnings is allowed and when that is related to a common denominator there results a ratio known as a rate of return. A rate base may be a very convenient reference point where if all conditions meet a certain standard, the base is

> value. Conditions that are usually encountered do not possess ideal characteristics; hence the appraiser must apply measurements of market attitudes to estimate market value. Thirdly, items includable in a rate base are not always taxable items; hence qualitatively they may be distinctly different. (Western Association, p.6)

As indicated by this statement, book value for rate purposes is rarely the same as market value for tax purposes. Even though railroads do not face the same rate regulation as many other utilities, it would logically follow that book value would rarely equal market value for railroad property. Some additional conclusions of the WATA regarding the cost approach are worth noting.

> In the case of regulated property where the rate base is keyed to historical or original cost, reference was made not to a reliance on book depreciation for measurement of loss in value but more strongly to earnings performance and the market attitude to that performance. Finally, in the discussion of reproduction and replacement costs, those costs are appropriate only when measured by prudency. The prudent investor examines the market and concludes that a certain investment in a certain field will return to him certain benefits (earnings) in preference to other alternate investments. So it can be analyzed that the cost approach can be used if all the legitimate adjustments to costs (new) are made to result in an estimate of market value. No doubt, authors have sensed this or analyzed it similarly, that energies are wasted in seeking the correct cost approach and then theorizing all the adjustments that the given approach must have. They probably conclude to go to the earnings approach which has all the peculiarities and individual characteristics submerged in its three variables; namely, quantity of income, duration of stream of income, and the discount rate. As stated earlier, these three variables pose problems of their own.... If a cost figure can be adjusted realistically to reflect an approximate market value, it could be used in conjunction with other indicators of value to provide relative stability to a formulaic result. (Western Association, p. 7)

Income Approach

The income approach to estimating market value is based on the premise that the current value of an income-producing property is represented by the discounted total future earnings of the property. This approach can be illustrated algebraically.

$$V = \frac{I}{r}$$

Where: V is the current value;
I is the income, and
r is the discount or capitalization rate.

The algebraic simplicity of the formula belies its complexity. While it is evident that value is wholly dependent on income (I) and the capitalization rate (r), it is much more difficult to determine precisely what "income" is, and also, what figure should be used as the capitalization rate.

At least two problems arise immediately when dealing with the income variable. The first is which type of income to use: gross operating revenue; gross operating revenue less operating expenses; gross operating revenue less operating expenses and depreciation; gross operating revenue less operating expenses, depreciation, and federal income tax; net income; etc. The second problem, assuming a certain level of income is deemed appropriate, is establishing the total future income. Because the actual future earnings of a property cannot be known until they are historical facts, some estimate must be made of the future earnings. This is typically done through an examination of past earnings and recent and future additions to income-producing plant.

Given the assumptions, estimates, projections, and so on that must be made with respect to income, it is easy to speculate on potential disagreements arising between the taxpayer's estimate of value and the appraiser's.

The second variable in the value formula, the capitalization rate (r), generates at least as must controversy as the income variable. Although there are undoubtedly many reasons behind the controversies, none is more evident than the fact that a seemingly minimal change in the capitalization rate results in a considerable difference in current value and, hence, taxes paid.

Even given the difficulties in establishing values to "plug-in" to the income approach formula, the approach itself has widespread support as a surrogate for market value. At a recent seminar on the appraisal of utility and railroad property, three noted experts commented on the approach's strengths.

> A properly computed income approach is the most reliable of the three measures of value. [T]he income approach goes to the very essence of value for income-producing property, and measures value without the qualifications inherent in the cost and the stock and debt approaches.
>
> Clarence M. Brasfield
> Division Staff Manager-Taxes
> Southern Bell, Atlanta, Georgia

> In terms of flexibility and adaptation to specific appraisal conditions, the income approach ranks first. Complex appraisal problems may be resolved through use of the income approach when the appraiser utilizes knowledge and skill appropriately. More conventional appraisal problems may be addressed with relative ease. The market value standard can be achieved in either case through careful adherence to the principles of the income approach.
>
> Seth L. Franzman
> Arizona Department of Revenue

> In the valuation of railroad and utility property, I would rank the income approach above the cost approach and generally on a par, or above, the market data approach when estimating value. The income approach can be applied to all types of property that is purchased with the expectation of monetary profit. If the income is properly estimated, that is as change in net wealth over time, and is properly discounted, that is adjusted for risk and time, the indication of value is consistent with the action of investors in the marketplace.
>
> Arlo Woolery, Executive Director
> Lincoln Institute of Land Policy

The foregoing statements lend considerable support to the income approach as the best single approach to estimating market value. However, each of the experts would also consider the other two approaches to valuation. This leads to an examination of the third approach, stock and debt.

Stock and Debt Approach

The stock and debt approach to valuation is based on the estimates of value relied on in the nation's financial markets. The formula for the stock and debt approach is taken from the most basic of accounting equations, Assets equals Liabilities plus Capital. Since the information being sought is the value of the taxable assets, the information can be quantified by valuing the liabilities and capital, and then subtracting the value of all nontaxable assets.

Like the other two approaches, the apparent simplicity of the stock and debt approach belies its real complexities. Determining a value for common stock, preferred stock, long-term debt, and liabilities is the lesser and simpler of the tasks required in this approach. The larger and more difficult task is the determination of nonoperating assets, i.e., assets not subject to tax, to be subtracted from the total asset value.

The real strength of this approach lies in the premise that the financial markets' indicators of value, i.e. stocks and bonds, accurately reflect the market value of the property. Whether or not the premise is valid is another issue, even recognizing that the judiciary has accepted this method since the mid-nineteenth century. (Thompson, p. 80.)

Arlo Woolery contends that the principal weakness in the stock and debt approach is the same as in the other approaches.

> [The weakness lies] not in the approach or the theory that underlies the approach, but rather in our deficiencies as appraisers. Our limited ability to process and understand the large amount of market data lies behind our inability to achieve defensible market values by any of the three indicators. (The Income Approach, pp. 10-11.)

Correlation of Valuation Approaches

Because each of the approaches to valuation has identifiable strengths and weaknesses, most appraisers rely on all three when estimating value. The "weight" given to the values resulting from each of the approaches is commonly referred to as the "correlation" of the approaches. This correlation is largely affected by the confidence an appraiser has in any of the approaches (in any given appraisal).

Even though many experts would advise against simply averaging the values indicated by the three approaches or predetermining any other weighting scheme, many states do precisely that, either through statute or administrative rule. The Montana Department of Revenue, for example, while not working under a statutorily imposed weighting scheme, has an agreement with the Burlington Northern railroad that the weighting (through 1985) will be 10% for the value indicated by the cost approach, 50% for the income approach

value, and 40% for the stock and debt indicator. Whether these are (or will be) the appropriate weights can only be judged through hindsight.

Allocation of Value

Once the value of the utility or railroad as an operating unit has been finally determined, a second determination must be made as to what portion of the unit's value is attributable to the a particular taxing jurisdiction. This process is called allocation.

There are many factors that can affect the allocation of value. Robert McSwain, a recognized expert in utility appraisal, in a recent presentation on railroad and utility valuation, categorized the factors into three types: property factors, income factors, and use factors. (McSwain and Shank, pp. 29-30.)

Property factors, according to McSwain, are the most reliable, the most available, and the most widely used for allocation of utility property. With the special case of railroads, property factors are combined with income and use factors for allocation. For railroads, property factors would include the value of property (as indicated by cost) and track miles. (McSwain and Shank, p. 29.)

Income factors, consisting of some measure of revenue, are unreliable, difficult to measure, and difficult to audit or support. Use factors, too, with the exception of airlines and railroads, are very difficult to measure. The use factors for railroads include measures such as car miles, locomotive miles, car days, and ton miles.

Finally, whatever set of factors is used in the allocation of the unit's value, the appraiser must ensure that the

factors reasonably reflect the value allocable to the taxing jurisdiction. Invalid allocation factors can only lead to importation or exportation of real value, a situation that must be avoided to assure an accurate valuation.

Preliminary Recap

With respect to taxation, there is no single element in the tax equation more important than valuation. Valuation is the factor upon which all other tax variables depend.

Of the three approaches to valuation of utility and railroad property -- cost, income, and stock and debt -- none is universally accepted by appraisal experts as the one best approach. While the income approach currently enjoys the most support, professional appraisers advocate that value be estimated using all three, each having strengths which serve as checks to the other approaches. Consequently, a correlation of the three values results in the best indication of market value of the entire unit.

Once a defensible unit value is calculated for the property, factors reflecting the value of the property allocable to the relevant taxing jurisdiction must by selected. Considerable attention should be given to selecting the allocation factors to ensure that the allocated value is an accurate representation of the value of the property within the jurisdiction.

Property Assessment in Montana

Montana statutes require that all taxable property "must be assessed at 100% of its market value". (§15-8-111, MCA.) As in all states, Montana considers market value as the value of the property assuming an arm's-length transaction between a willing buyer and a willing seller, both with

reasonable knowledge of all relevant facts. In addition, all property must be revalued at least once every five years. (§15-7-111, MCA.) The purpose of these provisions is to ensure that all property is valued fully and equitably.

For most types of property the system provided in Montana statutes works reasonably well. However, due to federal legislation, some types of property are assured protection from state-imposed tax discrimination. Property granted this protection includes railroad transportation property, airlines, and some property involved in interstate trucking.

The protection involves, for the most part, assurances that federally protected property is not taxed in a discriminatory manner. And perhaps because the first element required to calculate property taxes is the property's value, the federal legislation is keyed toward ensuring equity in assessment. (See Appendices A, B, and C.)

Assurances of Equitable Assessment

As mentioned earlier in this paper, the provisions of federal law requiring nondiscriminatory tax treatment of railroad transportation property are found in Section 306 of the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act). Air carrier property is guaranteed the same treatment under the Tax Equity and Fiscal Responsibility Act of 1982 as is motor carrier (trucking) property under the Motor Carrier Act of 1980.

Although the wording in each of the Acts varies, the effects of it does not. As stated in the 4-R Act, there is a proscription against any

> . . . assessment (but only to the extent of any portion based on excessive values as hereinafter described), for purposes of a property tax levied by any taxing district, of transportation property at a value which bears a higher ratio to the true market value of such transportation property than the ratio which the assessed value of all other commercial and industrial property in the same assessment jurisdiction bears to the true market value of all such other commercial and industrial property.

This federal mandate requires states to establish the true market value for all commercial and industrial property, including federally protected property and, subsequently, to determine at what percentage of true market value commercial and industrial property and protected property are assessed. The final federal requirement is that the level of assessment and taxation is no higher for protected property than that applicable to other types of commercial and industrial property.

Assumptions made in the development of policy alternatives

The policy alternatives presented by Oppedahl, staff researcher to the Montana Legislative Revenue Oversight Committee, are based on several assumptions. The assumptions serve partly to explain the alternatives but more importantly they serve to narrow the universe of alternatives. The following are Oppedahl's assumptions:

> (1) The Legislature wishes to design a taxation system that complies with the federal acts cited above in a manner that does not discriminate against railroad, trucking, or air carrier transportation property.
>
> (2) The alternatives chosen by the Legislature will be in place by the time the current agreement between the State and Burlington Northern, Inc. expires at the end of calendar year 1985.
>
> (3) The alternatives will not require changes in the Montana Constitution.

(4) To the extent possible, the alternatives will not create major shifts in present tax burdens within or between classes.

(5) Current valuation methods will continue to be employed.

(6) The owners of federally protected properties will report information necessary for state officials to comply with federal law.

(7) The Legislature can reasonably inquire into and rely upon arguments made by railroad, trucking, and air carrier transportation property owners in legal cases in Montana and other states in arriving at a workable system of compliance. This would include arguments in jurisdictions such as Ohio relating to the feasibility of separating unit appraisals into real and personal property;

(8) Sales/assessment ratio studies on real and personal property will be available to state officials when necessary in order to meet compliance requirements.

(9) The Legislature will provide the Department of Revenue with adequate budgetary support to meet problems of compliance. (Oppedahl, pp. 3-4.)

Options for Meeting the Requirements of the 4-R Act

Options available to the states regarding the 4-R Act and other federal legislation aimed at aiding the transportation industry are severely limited; in fact, Oppedahl noted only three basic options. (See Appendix D.) It would appear that his inventory is fairly complete.

The first option noted by Oppedahl was exemption of federally protected property. This would affect state revenues collected under fixed mill levies and could create a potential shifting of tax burden where levies are flexible.

Oppedahl's second option was to effectively create a two-class system -- a class subject to federal legislative policy and a class subject to state legislative policy. This included authorizing the administrative adjustment of both the assessment level and the tax rate of federally protected property to that of all other commercial and industrial property.

His third option was to statutorily restructure Montana's property tax classification system into two categories of property -- commercial and industrial, and all other taxable property. Commercial and industrial property could be appraised annually and taxed at one rate. Identical assessment dates and tax rates for all commercial and industrial property would assure compliance with federal laws.

A variation of Oppedahl's third option would include some elements of his second option as well. This would be a categorization of taxable property into commercial and industrial property, and noncommercial/industrial. Under this system, Montana could maintain its current classification system. However, an annual sales ratio study of all commercial and industrial property would have to be done, with the results applied to federally protected property to assure compliance with federal law.

Under all of the identified options, the Legislature would, in some fashion, be required to address the following issues:

1. Some definition of what constitutes commercial and industrial property will have to be made. This does not necessarily require a redefinition of property classes, but could instead be accomplished through the assignment of current property to either the commercial and industrial category, or to the category of property other than commercial and industrial.

2. Some method of obtaining reliable information with which to compare valuations will have to be developed. This might include an annual assessment/sales ratio study of a statistically significant sample of commercial/industrial property sales.

3. A policy decision will have to be made as to whether different tax categories should be developed for real and personal property within the broad classes of commercial and industrial and noncommercial/industrial. If the decision is in favor of different categories for realty and personalty, further definitions will be necessary.

4. A method of accounting for the value of mineral and nonmineral natural resources (subject to net or gross proceeds tax as a measure of market value) will have to be developed. As Oppedahl notes, the value of this type of property lies in the value of the severed resource and hence indicates personal property rather than real property.

5. Some estimate of the effects of the Legislature's policy decision(s) will have to be made in order to give notice to local governments of changes in taxable value and the resultant changes in tax revenues from federally protected property.

Summary

Under the 4-R Act and similar federal legislation regarding other protected transportation property, states' options in taxing the protected property are limited. Each of the federal Acts is aimed at eliminating discriminatory treatment of the protected property in matters of property taxation. The purpose of the Acts is clearly that of equalization.

With respect to the purpose of equalization, Montana must make some revisions to its current property tax system. Those revisions seem to be limited to either exemption of protected property from property taxation, or some type of adjustment to Montana's current classification system.

RECOMMENDATION

On December 8, 1984, the Revenue Oversight Committee adopted a motion to recommend to the 49th Legislature LC 420, a bill to generally revise Montana's property tax laws. (See Appendix D.) Beyond the general revision, the provisions of the draft legislation would bring Montana's property tax laws into conformance with federal legislation. Among the reasons behind the Committee recommendation were:

* the need to bring Montana's property tax laws into conformance with federal legislation;
* the need to preserve Montana's property tax base; and
* a desire to preserve as much of the existing property tax classification system as possible.

In addition to recommending LC 420, the Committee also adopted a motion to have a bill drafted that would be based on LC 420 with the exceptions that all residential, commercial, and industrial real property and improvements would be in one class of property rather than in two. Additionally, the Department of Revenue would be given the responsibility of determining the assessment and tax level of all commercial real property, regardless of the class in which it was included.

Each of these draft bills followed the Committee's only real alternative: revising Montana's property tax laws. As phrased by the Committee's Chairman, the recommendation was an effort to retain the authority to make a state policy decision in the Legislature rather than turning the decision over to the federal judiciary.

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SUPPLEMENT TO APPENDICES A, B, AND C

FEDERAL ACTS AND THEIR REQUIREMENTS

Three acts of the United States Congress passed in 1976, 1980, and 1982 prohibit 'discriminatory' taxation of railroad, trucking, and air carrier transportation property. All three acts share common principles. They declare that certain tax practices unreasonably burden interstate commerce. And they define such tax practices to be the application to "protected property" of any state or local assessment or tax rate that is higher for the protected property than it is for all other commercial and industrial property in the same jurisdiction. Simply stated the acts require: (1) that assessment of railroad, trucking, and air carrier transportation property be equalized with or lower than the assessment of other commercial and industrial property; and (2) that the tax rate applied to railroad, trucking, and air carrier transportation property be the same rate (or less) than the rate that is applied to all other commercial and industrial property.

The three acts are not identical. The 4-R Act is the most comprehensive statement of federal policy. The 1980 Motor Carriers Act has all the provisions of the 4-R Act except section (1)(d), which prohibits the imposition of "any other tax which results in discriminatory treatment". The 1982 act that applies to air carrier transportation property lacks provisions common to the other two acts in the areas of immediate access to federal court, statements preferring sales/assessment ratio studies, and the section (1)(d) prohibition against any other tax. These differences mean that state compliance with federal requirements appear to be less difficult in the case of air carrier transportation property than for other protected property.

SOURCE: "Options for Complying with the 4-R Act and Similar Federal Legislation" by Jim Oppedahl, memo to the Revenue Oversight Committee, Montana Legislative Council, Helena, Montana, May 29, 1984.

APPENDIX D

Taken from: "Options for Complying with the 4-R Act and Similar Federal Legislation" by Jim Oppedahl, memorandum to the Revenue Oversight Committee, Montana Legislative Council, Helena, Montana, May 29, 1984.

ALTERNATIVES FOR COMPLYING WITH FEDERAL ACTS

The federal acts under discussion here basically require states to determine the assessment level and effective tax rate generally applicable to all commercial and industrial property -- excluding the specific federally protected property -- and then to apply the assessment level and tax rate so determined to the protected property. If the ratio of the assessed value of all other commercial and industrial property to the true market value of all other such commercial and industrial property cannot reasonably be determined within an acceptable tolerance of 5 percentage points, then the assessment/sales ratio for all property -- excluding protected property -- is to be used in setting the assessment level for the protected property. (This provision does not apply to air carrier transportation property.)

The federal acts seem to allow classified property tax states like Montana only three alternatives for compliance:

1. Exempt federally protected property from taxation.

2. Establish legislative authority for administratively adjusting both the assessment level and the tax rate of protected property to the level of all other commercial and industrial property -- or to the level of all other property if the level of commercial and industrial property cannot be determined within the 5% guideline mandated by federal law.

3. Establish a property tax system that treats federally protected property and all other commercial and industrial property exactly alike -- both on the basis of assessment level and the tax rate.

ALTERNATIVE ONE: Exemption

The first alternative would exempt federally protected property from taxation. This alternative could be accomplished by deleting federally protected property from the classification system and placing it into section 15-6-201[, MCA,] which relates to exempt property. There would be a tax loss at the state and local level wherever fixed mill levies occurred but elsewhere taxes would be shifted to other taxpayers.

ALTERNATIVE TWO: Administrative Calculation

The second alternative would create essentially two classes of property in Montana. The first class would consist of property subject to federal legislative policy while the second class would consist of property subject to state legislative policy. State laws relating to [the] first class [of] property would be limited to legislative guidelines to the Department of Revenue on how to administer federally mandated assessment levels and tax rates to be applied to protected property. This alternative could include a provision about what state policy would be in the event that federal policy requirements were removed in the future.

The first alternative has at least two variations, depending on the amount of specificity that the Legislature desires.

If little specificity is deemed desirable, current Montana law would probably suffice. Section 15-23-202, [MCA,] dealing with assessment of railroads, states:

> (2) In determining the taxable value of railroad property, the department [of revenue] may modify the percentage multiplier provided for in 15-6-141 [15%] in order to achieve compliance with the requirements of the federal Railroad Revitalization and Regulatory Reform Act of 1976, as amended.

If this section were amended as follows (incorporating both federal and state policy), it could be applied to all federally protected property:

> (2) In determining the taxable value of railroad property, the department ~~may modify~~ shall set the percentage multiplier provided for in 15-6-141 at the maximum federally allowable rate, not to exceed 15%, in order to achieve compliance with the assessment level and tax rate requirements of the federal Railroad Revitalization and Regulatory Reform Act of 1976, the Motor Carrier Act of 1980, and section 532 of the Tax Equity and Fiscal Responsibility Act of 1982, as amended.

This alternative would probably benefit from a general statement of legislative purpose that could be used by the [Montana] Department of Revenue in establishing rules for administering such a policy.

If the Legislature determined that a more detailed outline was necessary for guiding the Department of Revenue, it could add detailed procedures for the Department to follow in establishing the assessment level and tax rate comparison between commercial and industrial property and the federally protected property. These details could be provided either in statute or by adopting a bill -- accompanied by a statement of intent -- directing the Department to adopt rules.

Details would have to include several definitions. Legislation would certainly have to define what constituted commercial and industrial property so that a clear procedure existed for the Department to examine property in each class and arrive at the generally applicable assessment level and tax rate. The definition of commercial and industrial could be adapted from current Department rules on commercial and industrial property. . . .

Another important element of detail would be deciding whether to require the Department to separate property into categories of real and personal property for purposes of calculating the appropriate adjustments to federally protected property. The appropriate use of statistical averages in various calculations (average; median; parcel weighted mean; value weighted mean; etc.) might also be the subject of legislative policy.

One of the more troublesome issues here would be how to include net and gross proceeds of mines in the definition of commercial and industrial property. The value of mines and mining claims in Montana is taxed by assuming that the annual net or gross proceeds of the mine over the life of the mineral operation will accurately reflect the total economic value of the mineral. When there is no mineral production, there is no tax on the minerals in the ground. It is debatable whether the value and treatment of mineral properties is therefore comparable to other kinds of property subject to property taxation.

Also, it is somewhat difficult to comprehend how one is to apply the percentages that are used in the taxation of other non-mining mineral property. Oil and gas net proceeds are taxed at 100% of net proceeds. Are net proceeds 100% percent of market value? Is this kind of property taxed at 100% -- and is that percentage figure to be used in

calculating the tax rate generally applicable to commercial and industrial property?

An additional complication arises because, while the net and gross proceeds is imposed in lieu of taxing the real property value of the total mineral deposit, the incidence of the tax falls on the severed mineral -- which is personal property. Some have argued that personal property should not be included in determining the assessment level of commercial and industrial property since the sales/assessment ratio studies envisioned by Congress in the 4R Act were limited to studies of real property. How should this issue be treated in calculations?

Several other issues could be dealt with by statute or rule. As mentioned earlier, where the market value of federally protected property is determined using a unit method of appraisal, the state may want to direct the Department of Revenue to separate the unit value into its components of real and personal property before setting the assessment level or tax rate. This may be a particularly important issue when the nature of the federally protected property is primarily real or primarily personal property as in the case of trucking or air carrier transportation property. It is also important when the appraisal cycles of non-protected real and personal property are substantially different than the appraisal cycles for protected property.

Finally, general instructions outlining state policy on the conduct of sales/assessment ratio studies could include details on how the studies would be applied, what sales are included, whether to include personal property, and so forth in order to clarify the state's taxation policy.

ALTERNATIVE THREE: Structural Changes to the Classification System

The third alternative would actually restructure the current property tax classification system in order to achieve compliance with federal law. This alternative would establish two broad classes of property: Class A property would be all taxable commercial and industrial property in the state and Class B property would consist of all other taxable property. Class B property has no federal policy mandates that have to be complied with so it need not be dealt with here.

Class A property -- commercial and industrial -- could be dealt with in at least two ways. Commercial and industrial property (including federally protected property) could be placed into one large class and appraised annually. All the property would be on an annual appraisal cycle and taxable at the same rate. With federally protected property and all other commercial and industrial property on the same assessment level and tax rate, the state would be in compliance with federal law.

This alternative would involve the same definitional problems of what constitutes commercial/industrial property as the second alternative and would involve examining applicable federal law, court cases, and case-by-case determinations. This alternative might also want to incorporate the separation of real and personal property within the class of commercial/industrial property in order to maintain the state's ability to make equitable adjustments as between different kinds of property.

A second way of dealing with alternative three would be to divide the current property tax classification system into two classes; one commercial/industrial and the other

non-commercial/industrial. As with current Montana law, the assessment cycles and tax rates could still vary between classes. However, an annual assessment/sales ratio study would have to be conducted in order to calculate the equalization and tax rate that was to be applied to federally protected property. This, then, is a combination of both alternatives two and three but actually separates commercial/industrial property from other property within the classification scheme.

_____ BILL NO. _____

INTRODUCED BY _____

BY REQUEST OF THE REVENUE OVERSIGHT COMMITTEE

A BILL FOR AN ACT ENTITLED: "AN ACT TO GENERALLY REVISE MONTANA PROPERTY TAX CLASSIFICATION LAW TO COMPLY WITH FEDERAL LAW GRANTING CERTAIN TYPES OF PROPERTY SPECIAL CONSIDERATION; REQUIRING THE DEPARTMENT OF REVENUE TO ANNUALLY REVALUE ALL COMMERCIAL AND INDUSTRIAL PROPERTY; REQUIRING THE DEPARTMENT OF REVENUE TO CONDUCT AUDITS OF ASSESSMENTS ON COMMERCIAL AND INDUSTRIAL PROPERTY; AMENDING SECTIONS 15-6-101, 15-6-134, 15-6-135, 15-6-137 THROUGH 15-6-142, 15-6-151, 15-7-111, 15-7-202, 15-7-307, 15-8-104, 15-8-111, 15-16-611, AND 15-23-202, MCA; AND PROVIDING EFFECTIVE DATES."

WHEREAS, the federal government has granted special consideration to certain types of property with respect to property taxation; and

WHEREAS, the Legislature and the people of the State of Montana desire to be in full compliance with all federal law; and

WHEREAS, there have been questions in the past regarding the validity of Montana's property tax classification laws with respect to federal law granting special consideration to certain types of property; and

WHEREAS, state tax policy is best determined by the state's primary policymaking body, which is the Legislature; and

WHEREAS, the Legislature wishes to retain as much as possible the sovereignty guaranteed to the State by the 10th amendment to the Constitution of the United States of America; and

WHEREAS, the 48th Legislature of the State of Montana adopted House Joint Resolution 31, requiring a study of Montana's property tax classification system; and

WHEREAS, the Revenue Oversight Committee has examined Montana's property tax system; and

WHEREAS, that examination causes the Revenue Oversight Committee to recommend a general revision of Montana's property tax classification system.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 15-6-101, MCA, is amended to read:

"15-6-101. Property Purpose -- property subject to taxation -- classification. (1) It is the purpose of this chapter to comply with federal law requiring special consideration of certain types of property. To meet the requirements of federal law, the legislature finds it necessary to separate the several types of property into

classes, each class containing property reasonably related to other property in the same class and reasonably different from property in every other class. It is further the purpose of this chapter and the policy of the legislature to treat all similar property subject to taxation in an equitable manner.

~~(1)~~(2) All property in this state is subject to taxation, except as provided otherwise.

~~(2)~~(3) For the purpose of taxation, the taxable property in the state shall be classified in accordance with ~~15-6-131 through 15-6-141~~ this part."

Section 2. Section 15-6-134, MCA, is amended to read:

"15-6-134. Class four property -- description -- taxable percentage. (1) Class four property includes:

(a) all noncommercial land, including, for farm homes, 1 acre of agricultural land at market value, except that specifically included in another class;

(b) all noncommercial improvements except those specifically included in another class;

(c) a trailer or mobile home used as a residence except when:

(i) held by a distributor or dealer of trailers or mobile homes as his stock in trade; or

(ii) specifically included in another class;

~~(c)~~(d) the first $35,000 or less of the market value

of any improvement on real property and appurtenant land not exceeding 5 acres owned or under contract for deed and actually occupied for at least 10 months a year as the primary residential dwelling of:

(i) a widow or widower 62 years of age or older who qualifies under the income limitations of (iii) of this subsection;

(ii) a widow or widower of any age with dependent children who qualifies under the income limitations of (iii) of this subsection; or

(iii) a recipient or recipients of retirement or disability benefits whose total income from all sources including otherwise tax-exempt income of all types is not more than $8,000 for a single person or $10,000 for a married couple;

(e) the first $35,000 or less of the market value of a trailer or mobile home used as a residence and actually occupied for at least 10 months a year as the primary dwelling of any person described in subsections (1)(d)(i) through (1)(d)(iii);

~~(d)~~(f) all golf courses, including land and improvements actually and necessarily used for that purpose, that:

(i) consist of at least 9 holes and not less than 3,000 lineal yards; and

(ii) were used as a golf course on January 1, 1979, and were owned by a nonprofit Montana corporation.

(2) Class four property is taxed as follows:

(a) ~~Except as provided in 15-24-1402 or 15-24-1501,~~ property Property described in subsections (1)(a) ~~and (1)(b)~~ through (1)(c) is taxed at 8.55% ___% of its market value.

(b) Property described in ~~subsection (1)(c)~~ subsections (1)(d) and (1)(e) is taxed at 8.55% ___% of its market value multiplied by a percentage figure based on income and determined from the following table:

Income Single Person	Income Married Couple	Percentage Multiplier
$0 - $1,000	$0 - $1,000	0%
1,001 - 2,000	1,001 - 2,000	10%
2,001 - 2,800	2,001 - 3,000	20%
2,801 - 3,600	3,001 - 4,000	30%
3,601 - 4,400	4,001 - 5,000	40%
4,401 - 5,200	5,001 - 6,000	50%
5,201 - 6,000	6,001 - 7,000	60%
6,001 - 6,800	7,001 - 8,000	70%
6,801 - 7,600	8,001 - 9,000	80%
7,601 - 8,000	9,001 - 10,000	90%

(c) Property described in subsection ~~(1)(d)~~ (1)(f) is taxed at one-half the taxable percentage established in subsection (2)(a), or 4.275% ___%."

Section 3. Section 15-6-135, MCA, is amended to read:

"15-6-135. Class five property -- description -- taxable percentage. (1) Class five property includes:

(a) all property used and owned by cooperative rural electrical and cooperative rural telephone associations organized under the laws of Montana, except property owned by cooperative organizations described in ~~subsection (1)(c) of 15-6-137~~ 15-6-139(1)(u);

(b) air and water pollution control equipment as defined in this section;

(c) new industrial property as defined in this section;

(d) any personal or real property used primarily in the production of gasohol during construction and for the first 3 years of its operation.

(2) (a) "Air and water pollution equipment" means facilities, machinery, or equipment used to reduce or control water or atmospheric pollution or contamination by removing, reducing, altering, disposing, or storing pollutants, contaminants, wastes, or heat. The department of health and environmental sciences shall determine if such utilization is being made.

(b) The department of health and environmental sciences' determination as to air and water pollution equipment may be appealed to the board of health and

environmental sciences and may not be appealed to either a county tax appeal board or the state tax appeal board. However, the appraised value of the equipment as determined by the department of revenue may be appealed to the county tax appeal board and the state tax appeal board.

(3) "New industrial property" means any new industrial plant, including land, buildings, machinery, and fixtures, used by new industries during the first 3 years of their operation. The property may not have been assessed within the state of Montana prior to July 1, 1961.

(4) (a) "New industry" means any person, corporation, firm, partnership, association, or other group that establishes a new plant in Montana for the operation of a new industrial endeavor, as distinguished from a mere expansion, reorganization, or merger of an existing industry.

(b) New industry includes only those industries that:

(i) manufacture, mill, mine, produce, process, or fabricate materials;

(ii) do similar work, employing capital and labor, in which materials unserviceable in their natural state are extracted, processed, or made fit for use or are substantially altered or treated so as to create commercial products or materials; or

(iii) engage in the mechanical or chemical

transformation of materials or substances into new products in the manner defined as manufacturing in the 1972 Standard Industrial Classification Manual prepared by the United States office of management and budget.

(5) New industrial property does not include:

(a) property used by retail or wholesale merchants, commercial services of any type, agriculture, trades, or professions;

(b) a plant that will create adverse impact on existing state, county, or municipal services; or

(c) property used or employed in any industrial plant that has been in operation in this state for 3 years or longer.

(6) Class five property is taxed at 3% ~~1~~ of its market value."

Section 4. Section 15-6-137, MCA, is amended to read:

"15-6-137. Class seven property -- description -- taxable percentage. (1) Class seven property includes:

(a) all property ~~used-and--owned--by--persons,--firms, corporations,-or-other-organizations-that-are-engaged-in-the business--of-furnishing-telephone-communications-exclusively to-rural-areas-or-to-rural-areas-and-cities-and-towns-of-800 persons-or-less~~;

(b)--all-property-owned-by-cooperative-rural-electrical and-cooperative-rural-telephone-associations-that-serve-less

than-95%-of-the-electricity--consumers--or--telephone--users within-the-incorporated-limits-of-a-city-or-town;

(c)--electric--transformers--and-meters;-electric-light and-power-substation-machinery;-natural--gas--measuring--and regulating-station-equipment;-meters;-and-compressor-station machinery--owned--by-noncentrally-assessed-public-utilities; and-tools--used--in--the--repair--and--maintenance--of--this property;-and

(d)--tools;--implements;--and--machinery-used-to-repair and-maintain-machinery-not-used-for-manufacturing-and-mining purposes;

(2)--To-qualify-for-this--classification;--the--average circuit---miles---for---each---station---on---the---telephone communication-system-described-in-subsection-(1)(b)-must--be more--than--1-mile; used for noncommercial purposes which is not real property or an improvement to real property and which is not in another class; and

(b) all agricultural machinery and equipment used in a bona fide farm, ranch, or stock operation.

(3)(2) Class seven property is taxed at 8% __ % of its market value."

Section 5. Section 15-6-138, MCA, is amended to read:

"15-6-138. Class eight property -- description -- taxable percentage. (1) Class eight property includes:

(a) all agricultural--implements--and--equipment land except that specifically included in another class; and

(b) all improvements except those specifically included in another class.

(b)--all-mining-machinery,-fixtures,-equipment,--tools, and-supplies-except:

(i)--those-included-in-class-five;-and

(ii)-coal-and-ore-haulers;

(c)--all--manufacturing-machinery,-fixtures,-equipment, tools,-and-supplies-except-those-included-in-class-five;

(d)--motorcycles;

(e)--watercraft;

(f)--all-trailers-up-to--and--including--18,000--pounds maximum--gross--loaded-weight,-except-those-subject-to-a-fee in-lieu-of-property-tax;

(g)--aircraft;

(h)--all-terrain-vehicles;

(i)--harness,-saddlery,-and-other-tack-equipment;

(j)--all-goods--and--equipment--intended--for--rent--or lease;--except-goods-and-equipment-specifically-included-and taxed-in-another-class;-and

(k)--all--other--machinery--except--that---specifically included-in-another-class;

(2) Class eight property is taxed at 11% __ % of its market value."

Section 6. Section 15-6-139, MCA, is amended to read:

"15-6-139. Class nine property -- description -- taxable percentage. (1) Class nine property includes:

(a) buses and trucks having a rated capacity of more than three-quarters of a ton but less than or equal to 1 1/2 tons;

(b) truck toppers weighing more than 300 pounds;

(c) furniture, fixtures, and equipment, except that specifically included in another class, used in commercial establishments as defined in this section;

(d) x-ray and medical and dental equipment; ~~and~~

(e) citizens' band radios and mobile telephones;

(f) all mining machinery, fixtures, equipment, tools, and supplies except those included in class five;

(g) all manufacturing machinery, fixtures, equipment, tools, and supplies except those included in class five;

(h) motorcycles;

(i) watercraft;

(j) all trailers up to and including 18,000 pounds maximum gross loaded weight, except those subject to a fee in lieu of property tax;

(k) aircraft;

(l) all-terrain vehicles;

(m) harness, saddlery, and other tack equipment;

(n) all goods and equipment intended for rent or lease, except goods and equipment specifically included and

taxed in another class;

(o) all other machinery except that specifically included in another class;

(p) radio and television broadcasting and transmitting equipment;

(q) cable television systems;

(r) coal and ore haulers;

(s) all trailers exceeding 18,000 pounds maximum gross loaded weight, including those prorated under 15-24-102 and except those subject to a fee in lieu of property tax;

(t) theater projectors and sound equipment;

(u) electric transformers and meters; electric light and power substation machinery; natural gas measuring and regulating station equipment, meters, and compressor station machinery owned by noncentrally assessed public utilities; and tools used in the repair and maintenance of this property;

(v) tools, implements, and machinery used to repair and maintain machinery not used for manufacturing and mining purposes; and

(w) all other property not included in any other class except that property subject to a fee in lieu of a property tax.

(2) "Commercial establishment" includes any hotel; motel; office; petroleum marketing station; or service,

wholesale, retail, or food-handling business.

(3) Class nine property is taxed at ~~13%~~ ___% of its market value."

Section 7. Section 15-6-140, MCA, is amended to read:

"15-6-140. Class ten property -- description -- taxable percentage. (1) Class ten property includes:

~~(a)--radio-and-television-broadcasting-and-transmitting equipment;~~

~~(b)--cable-television-systems;~~

~~(c)--coal-and-ore-haulers;~~

~~(d)--trucks-having-a-rated-capacity-of-more-than--1-1/2 tons;-including-those-prorated-under-15-24-102;~~

~~(e)--all-trailers-exceeding-18;000-pounds-maximum-gross loaded--weight;-including-those-prorated-under-15-24-102-and except-those-subject-to-a-fee-in-lieu-of-property-tax;~~

~~(f)--theater-projectors-and-sound-equipment;-and~~

~~(g)--all-other-property-not-included-in--the--preceding nine--classes--except-that-property-subject-to-a-fee-in-lieu of-a-property-tax:~~

(a) all railroad transportation property; and

(b) all airline transportation property.

(2) Class ten property is taxed at ~~16%-of--its--market value:~~ the percentage rate "R", to be determined by the department as provided in subsection (3).

(3) R = (A + B + C + D)/E, where:

(a) R is the taxable percentage applicable to class ten property;

(b) A is the total statewide taxable value of all property included in class eight and is determined by multiplying the total statewide market value of class eight property by the taxable percentage provided in 15-6-138;

(c) B is the total statewide taxable value of all property included in class nine and is determined by multiplying the total statewide market value of class nine property by the taxable percentage provided in 15-6-139;

(d) C is the total statewide taxable value of all property described in 15-6-141(1)(a), (1)(b), (1)(d), and (1)(e) and is determined by multiplying the total statewide market value of the property described in those subsections by the taxable percentage provided in 15-6-141(2)(a);

(e) D is the total statewide taxable value of all property described in 15-6-141(1)(c) and is determined by multiplying the total statewide market value of the property described in 15-6-141(1)(c) by the taxable percentage provided in 15-6-141(2)(b); and

(f) E is the total statewide market value of all property included in class eight, class nine, and class eleven.

(4) For the purpose of complying with the Railroad Revitalization and Regulatory Reform Act of 1976, the Tax

Equity and Fiscal Responsibility Act of 1982, and the Motor Carrier Act of 1980, as they read on [the effective date of this act]:

(a) the rate "R" referred to in subsection (2) is the average tax rate generally applicable to commercial and industrial property in Montana; and

(b) "commercial and industrial property" is all property included in class eight, class nine, and class eleven."

Section 8. Section 15-6-141, MCA, is amended to read:

"15-6-141. Class eleven property -- description -- taxable percentage. (1) Class eleven property includes:

(a) centrally assessed electric power companies' allocations;

(b) allocations for centrally assessed natural gas companies having a major distribution system in this state; and

(c) centrally assessed companies' allocations except:

(i) electric power and natural gas companies' property;

(ii) property owned by cooperative rural electric and cooperative rural telephone associations and classified in class five; and

(iii) property owned by organizations providing telephone communications to rural areas and classified in

class seven; nine; and

(iv) airline and railroad transportation property included in class ten;

(d) all property used and owned by persons, firms, corporations, or other organizations that are engaged in the business of furnishing telephone communications exclusively to rural areas or to rural areas and cities and towns of 800 persons or less; and

(e) all property owned by cooperative rural electrical and cooperative rural telephone associations that serve less than 95% of the electricity consumers or telephone users within the incorporated limits of a city or town where the average circuit miles for each station on the telephone communication system is more than 1 mile.

(2) Class eleven property is taxed as follows:

(a) Property described in subsection subsections (1)(a), and (1)(b), (1)(d), and (1)(e) is taxed at 12% 1% of market value.

(b) Except as provided in 15-23-202, property described in subsection (1)(c) is taxed at 15% 1% of market value."

Section 9. Section 15-6-142, MCA, is amended to read:

"15-6-142. Class twelve property -- description -- taxable percentage. (1) Class twelve property includes: all commercial timberland.

~~(a)--a--trailer--or--mobile--home--used--as-a-residence except-when:~~

~~(i)--held-by-a-distributor-or--dealer--of--trailers--or mobile-homes-as-his-stock-in-trade;-or~~

~~(ii)-specifically-included-in-another-class;~~

~~(b)--the-first-$35,000-or-less-of-the-market-value-of-a trailer--or--mobile--home--used--as-a-residence-and-actually occupied-for-at-least--10--months--a--year--as--the--primary residential-dwelling-of:~~

~~(i)--a--widow--or--widower-62-years-of-age-or-older-who qualifies-under-the-income--limitations--of--(iii)--of--this subsection;~~

~~(ii)-a--widow--or--widower--of--any--age-with-dependent children-who-qualifies-under-the-income-limitations-of-(iii) of-this-subsection;-or~~

~~(iii)-a--recipient--or--recipients--of--retirement---or disability--benefits--whose--total--income--from-all-sources including-otherwise-tax-exempt-income-of-all--types--is--not more--than--$8,000--for--a--single--person--or-$10,000-for-a married-couple;~~

(2) Commercial timberland is land in one ownership and from which is harvested ____ or more board feet during the appraisal cycle.

~~(2)~~(3) Class twelve property is taxed as follows:

~~(a)--Property--described--in--subsection-(1)(a)-that-is~~

~~not-of-the-type-described-in-subsection-(1)(b)-is--taxed--at 8.55%-of-its-market-value;~~

~~(b)--Property--described--in-subsection-(1)(b)-is-taxed at-8.55%-of-its-market--value--multiplied--by--a--percentage figure--based--on--income--and--determined--from--the--table established-in-subsection-(2)(b)-of-15-6-134~~ at ____ % of the combined appraised value of the standing timber and grazing productivity of the property."

Section 10. Section 15-6-151, MCA, is amended to read:

"15-6-151. Application for certain class four classifications. (1) A person applying for classification of property described in subsection ~~(1)(c)~~ (1)(d) or (1)(e) of 15-6-134 shall make an affidavit to the department of revenue, on a form provided by the department without cost, stating:

(a) his income;

(b) his retirement benefits;

(c) his marital status;

(d) the fact that he maintains the land and improvements as his primary residential dwelling, where applicable; and

(e) such other information as is relevant to the applicant's eligibility.

(2) This application must be made before March 1 of the year after the applicant becomes eligible. The

application remains in effect in subsequent years unless there is a change in the applicant's eligibility. The taxpayer shall inform the department of any change in eligibility. The department may inquire by mail whether any change in eligibility has taken place and may require a new statement of eligibility at any time it considers necessary.

(3) The affidavit is sufficient if the applicant signs a statement affirming the correctness of the information supplied, whether or not the statement is signed before a person authorized to administer oaths, and mails the application and statement to the department of revenue. This signed statement shall be treated as a statement under oath or equivalent affirmation for the purposes of 45-7-202, relating to the criminal offense of false swearing."

Section 11. Section 15-7-202, MCA, is amended to read:

"15-7-202. Eligibility of land for valuation as agricultural. (1) Land which is actively devoted to agricultural use shall be eligible for valuation, assessment, and taxation as herein provided each year it meets any of the following qualifications:

(a) the area of such land is not less than 5 contiguous acres when measured in accordance with provisions of 15-7-206, and it has been actively devoted to agriculture during the last growing season, and it continues to be actively devoted to agricultural use, which means:

(i) it is used to produce field crops including but not limited to grains, feed crops, fruits, vegetables; or

(ii) it is used for grazing and it is not classified as commercial timberland as defined in 15-6-142; or

~~(iii) it is used for growing timber; or~~

(iv)(iii) it is in a cropland retirement program; or

(b) it agriculturally produces for sale or home consumption the equivalent of 15% or more of the owners' annual gross income regardless of the number of contiguous acres in the ownership; or

(c) it is used to raise animals in confined areas for the production of food or fiber, including but not limited to livestock, feedlots, dairies, fish hatcheries, and poultry farms.

(2) Land shall not be classified or valued as agricultural if it is subdivided with stated restrictions prohibiting its use for agricultural purposes.

(3) The grazing on land by a horse or other animals kept as a hobby and not as a part of a bona fide agricultural enterprise shall not be considered a bona fide agricultural operation."

Section 12. Section 15-7-307, MCA, is amended to read:

"15-7-307. Certificate -- exceptions. The certificate imposed by this part shall not apply to:

(1) an instrument recorded prior to July 1, 1975;

(2) the sale of agricultural land when the land is used for agricultural purposes;

(3) the United States of America, this state, or any instrumentality, agency, or subdivision thereof;

(4) an instrument which (without added consideration) confirms, corrects, modifies, or supplements a previously recorded instrument;

(5) a transfer pursuant to court decree;

(6) a transfer pursuant to mergers, consolidations, or reorganizations of corporations, partnerships, or other business entities;

(7) a transfer by a subsidiary corporation to its parent corporation without actual consideration or in sole consideration of the cancellation or surrender of subsidiary stock;

(8) a transfer of decedents' estates;

(9) a transfer of a gift;

(10) a transfer between husband and wife or parent and child with only nominal actual consideration therefor;

(11) an instrument the effect of which is to transfer the property to the same party or parties;

(12) a sale for delinquent taxes or assessments, sheriff sale, bankruptcy action, or mortgage foreclosure;

(13) a transfer made in contemplation of death; or

(14) the sale of timberland when the land is classified

for tax purposes as commercial timberland."

Section 13. Section 15-8-111, MCA, is amended to read:

"15-8-111. Assessment -- market value standard -- exceptions. (1) All taxable property must be assessed at 100% of its market value except as provided in subsection (5) of this section and in 15-7-111 through 15-7-114.

(2) (a) Market value is the value at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.

(b) The market value of all motor trucks; agricultural tools, implements, and machinery; and vehicles of all kinds, including but not limited to motorcycles, aircraft, and boats and all watercraft, is the average wholesale value shown in national appraisal guides and manuals or the value of the vehicle before reconditioning and profit margin. The department of revenue shall prepare valuation schedules showing the average wholesale value when no national appraisal guide exists.

(c) For real property and improvements, in the absence of contradictory market data information, market value is considered to be replacement cost depreciated.

(3) The department of revenue or its agents may not adopt a lower or different standard of value from market value in making the official assessment and appraisal of the

value of property in 15-6-134 through ~~15-6-148~~ 15-6-141. For purposes of taxation, assessed value is the same as appraised value.

(4) The taxable value for all property in classes four through eleven is the percentage of market value established for each class of property in 15-6-134 through 15-6-141.

(5) The assessed value of properties in 15-6-131 through 15-6-133 is as follows:

(a) Properties in 15-6-131, under class one, are assessed at 100% of the annual net proceeds after deducting the expenses specified and allowed by 15-23-503.

(b) Properties in 15-6-132 under class two are assessed at 100% of the annual gross proceeds.

(c) Properties in 15-6-133 under class three are assessed at 100% of the productive capacity of the lands when valued for agricultural purposes. All lands that meet the qualifications of 15-7-202 are valued as agricultural lands for tax purposes.

(d) Properties in 15-6-142, under class twelve, are assessed at 100% of the combined appraised value of the standing timber and grazing productivity.

(6) Land and the improvements thereon are separately assessed when any of the following conditions occur:

(a) ownership of the improvements is different from ownership of the land;

(b) the taxpayer makes a written request; or

(c) the land is outside an incorporated city or town.

(7) The taxable value of all property in 15-6-131 and classes two, and three , and twelve is the percentage of assessed value established in 15-6-131(2), 15-6-132, and 15-6-133, and 15-6-142 for each class of property."

Section 14. Section 15-16-611, MCA, is amended to read:

"15-16-611. Reduction of property tax for property destroyed by natural disaster. (1) The department of revenue shall, upon showing by a taxpayer that some or all of the improvements on his real property or a trailer or mobile home (as described in 15-6-134(1)(c)) (b), (1)(d), and (1)(e) have been destroyed to such an extent that such improvements have been rendered unsuitable for their previous use by natural disaster, adjust the tax due and payable for the current year on the property under 15-16-102 as provided in subsection (2) of this section.

(2) To determine the amount of tax due for destroyed property, the county treasurer shall multiply the amount of tax levied and assessed on the property for the year by the ratio that the number of days in the year that the property existed before destruction bears to 365.

(3) This section does not apply to delinquent taxes owed on the destroyed property for a year prior to the year

in which the property was destroyed.

(4) For the purposes of this section, "natural disaster" includes but is not limited to fire, flood, earthquake, or wind."

Section 15. Section 15-23-202, MCA, is amended to read:

"15-23-202. Assessment -- how made. (1) The department must assess the franchise, roadway, roadbed, rails, rolling stock, and all other operating properties of all railroads operated in more than one county or more than one state. All rolling stock must be assessed in the name of the person owning, leasing, or using the same. Assessment must be made to the person owning or leasing or using the same and must be made upon the entire railroad within the state. The depots, stations, shops, and buildings erected upon the space covered by the right-of-way and all other property owned or leased by such person, except as above provided, shall be assessed by the department.

(2) In determining the taxable value of railroad property, the department ~~may--modify~~ shall determine the percentage multiplier provided for in ~~15-6-141~~ 15-6-140 in order to achieve compliance with the requirements of the federal Railroad Revitalization and Regulatory Reform Act of 1976, as amended."

Section 16. Section 15-7-111, MCA, is amended to read:

"15-7-111. Periodic revaluation of taxable property. ~~The~~ (1) Except as provided in subsection (2), the department of revenue shall administer and supervise a program for the revaluation of all taxable property within the state at least every 5 years. A comprehensive written plan of rotation shall be promulgated by the department fixing the order of revaluation of property in each county on the basis of the last revaluation of taxable property in each county prior to July 1, 1974, in order to adjust the disparities therein between the counties. The plan of rotation so adopted shall provide that all property in each county shall be revalued at least every 5 years or that no less than 20% of the property in each county shall be revalued in each year. The department shall furnish a copy of the plan and all amendments thereto to each county assessor and the board of county commissioners in each county.

(2) All property in class eight, class nine, class ten, and class eleven shall be revalued annually under a program developed, administered, and supervised by the department."

Section 17. Section 15-8-104, MCA, is amended to read:

"15-8-104. Department audit of taxable value -- costs of audit paid by department. (1) When in the judgment of the director of revenue it is necessary, audits may be made for the purpose of determining the taxable value of net proceeds

of mines and oil and gas wells and all other types of property subject to ad valorem taxation.

(2) The department of revenue shall conduct audits of the assessment of property in class eight and class nine to assure that the value of the property in those classes reflects market value.

~~(2)~~(3) The cost of ~~the~~ any audit performed under subsection (1) or (2) shall be paid by the department."

NEW SECTION. Section 18. Extension of authority. (1) The existing authority of the department of revenue to make rules on the subject of the provisions of this act is extended to the provisions of this act.

(2) The department may initiate rulemaking proceedings under this section on or after this act is passed and approved, but no rule adopted under this section may be made effective before January 1, 1986.

NEW SECTION. Section 19. Severability. If a part of this act is invalid, all valid parts that are severable from the invalid part remain in effect. If a part of this act is invalid in one or more of its applications, the part remains in effect in all valid applications that are severable from the invalid applications.

NEW SECTION. Section 20. Effective date. (1) This act, except section 17, is effective January 1, 1986.

(2) Section 17 and this section are effective on passage and approval.

-End-

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CHAPTER FIVE

SENATE JOINT RESOLUTION 23

INTRODUCTION

Senate Joint Resolution 23 passed by the 48th Legislature called for an intensive examination of Montana's tax credits, tax deductions, tax exclusions, and tax exemptions. For each of these respective tax adjustments, the Resolution requested the Revenue Oversight Committee to conduct the study by:

(1) identifying the costs and benefits of the adjustments to the State;

(2) identifying the legislative purposes of the adjustments;

(3) determining the effectiveness of the adjustments in meeting their legislative purpose; and

(4) identifying their beneficiaries.

Undeniably, the study called for in the Resolution was an ambitious one and, for various reasons, one that demanded a limiting of depth by the Committee.

Nevertheless, the Committee addressed each of the items called for in the Resolution, some in more detail than others. The Committee's examination is briefly related in this chapter, and is reported in two parts. The first part is a fairly detailed examination of property tax exemptions -- their historical purposes, costs, and beneficiaries.

The second part of this chapter is given to an examination of income tax deductions, exclusions, and credits. A lack of hard data adversely affected the Committee's ability to determine all of items requested, but what was found is reported.

PROPERTY TAX EXEMPTIONS
RELATED TO INSTITUTIONS OF PURELY PUBLIC CHARITY AND
EXCLUSIVELY EDUCATIONAL OR RELIGIOUS ACTIVITIES

Introduction

The following section of this chapter outlines some general background and options on charitable, educational, and religious property tax exemptions in Montana. It attempts to focus on options available to the Legislature in setting public policy on selected property tax exemptions. Exemptions for charity and educational purposes receive the most attention in the section. (See Appendix A for a list of exemptions.)

Property Tax Exemptions in the United States

All States have property tax systems that exclude or exempt, in part or in whole, certain kinds and classes of property. Historically, States have generally provided immunity from property taxes for governmental property and partial or total exemption for selected nongovernmental property.

Immunity of governmental property from property taxation, particularly federal property, has a long tradition in the U.S. The landmark U.S. Supreme Court decision in McCullough v. Maryland forbade States from taxing federal property. State and local government property generally follows the same pattern of being immune from property taxation -- under the often stated philosophy that taxing such property is tantamount to taking money from one pocket and placing it in the other. While some have criticized the logic of this metaphor as ignoring the fact that the pockets are sometimes in different pants, the exemption practice remains firmly rooted. Numerous programs have been developed at both the federal and state levels that attempt to provide a degree of compensation for the revenue losses due to the immunity from

taxation of governmental property. (Michael Harder and Henry Raimondo, Compensating Local Governments for Tax Exempt Federal and State Property: A Preliminary Report (Washington, D.C.: Advisory Commission on Intergovernmental Relations, 1977), pp. 2-4.)]

State property tax systems also provide various property tax exemptions for nongovernmental property. Such exemptions generally fall into four broad categories: charitable, educational, religious, and other. The category of "other" here represents such items as exemptions for dwellings of veterans, disabled and elderly, household goods, intangibles, and many other items that a Legislature may have identified for property tax exemption status. (The category of "other" is not examined in this report.)

The primary rationale behind exemptions varies with each type. Religious exemptions are usually justified as promoting a socially desirable activity and to recognize first amendment requirements to minimize governmental involvement with religion. The exemptions for charitable and educational secular private property are usually justified as promoting socially acceptable purposes and on the premise that "if, in the absence of a private enterprise, taxation would be necessary in order to discharge a needed function, the state may properly subsidize the institution which performs the service." (Alfred Balk, The Free List: Property Without Taxes (New York, N.Y: Russell Sage Foundation, 1971), pp. 20-27; and Jens P. Jensen, Property Taxation in the United States (Chicago, Ill.: University of Chicago Press, 1931), p. 11.) Other exemptions are bestowed in order to reward services to the public, eliminate items from the property tax system that are difficult or not worth taxing, provide economic incentives for using certain property, or provide tax relief for certain property owners. (Cynthia P.

Lehmann and Robert R. Statham, A Review of the Property Tax and Its Impact on Business (Washington, D.C.: Chamber of Commerce of the United States, 1973), p. 82.)

Levels of property tax exemptions -- both for governmental and nongovernmental property -- vary widely from state to state. Reliable information on exemptions has been available only in recent years and has numerous limitations. Assessors probably spend few resources on such non-revenue generating property, much exempt property is infrequently sold, and it is often built for a single, specialized use.

Table 1 presents information from 23 States and the District of Columbia that attempts to quantify the value of property excluded from the tax base by type of exemption.

According to an official of the U.S. Bureau of the Census, the $259.6 billion that has been identified in the category of totally exempt "is significantly understated" and "probably represents only the tip of the iceberg." (Interview by Jim Oppedahl with John Coleman, Chief, Governments Division, U.S. Bureau of the Census, May 24, 1984.) In the exemption categories listed in Table 1, governmental property represents 49.3% of the total; 8.7% is educational, 5.8% is religious, 5.7% is charitable, and 30.5% falls into the category of "other".

To provide a sense of perspective on the total exemptions represented by Table 1, a comparison table is presented that shows some partial exemptions. Table 2 represents exemptions of a portion of the value of certain property. These partial exemptions represent different property than the total exemption property presented in Table 1. Also, according to the Bureau of the Census, the values for the

TABLE 1

Value Analogous to Assessed Value for Excluded (Totally Exempt) Property, by Type of Exemption, for Selected States: 1981

(Millions of dollars. For meaning of symbols, see text)

State	Total	Governmental	Educational	Religious	Charitable	Other or unallocable
Total	259,576	127,925	22,477	15,027	14,878	79,269
Arizona[1]	1,255	599	78	54	(NA)	524
California[2]	14,204	(NA)	3,336	2,844	8,022	2
Colorado	3,717	2,855	128	297	363	74
District of Columbia	15,163	12,492	640	581	146	1,304
Florida	30,696	23,542	(NA)	(NA)	(NA)	7,154
Georgia[3]	4,365	(NA)	(NA)	(NA)	(NA)	4,365
Hawaii	5,085	4,128	109	275	260	313
Idaho[4]	17,049	9,863	707	502	30	5,947
Indiana	1,527	(NA)	(NA)	(NA)	(NA)	1,527
Iowa[1]	2,331	(NA)	339	1,107	651	234
Kansas[5]	2,585	(NA)	(NA)	(NA)	(NA)	2,585
Maine	4,047	2,509	506	274	195	563
Maryland	7,915	4,179	2,207	1,040	415	74
Massachusetts	16,156	11,146	2,207	827	1,729	247
Michigan[6]	17,411	6,967	(NA)	(NA)	(NA)	10,444
Minnesota[7]	16,108	5,802	6,291	1,920	540	1,555
Nevada	1,136	825	180	53	(NA)	78
New Jersey[8]	21,043	15,399	-	2,741	1,569	1,334
New Mexico	308	(NA)	(NA)	(NA)	(NA)	308
New York[9]	38,643	(NA)	(NA)	(NA)	(NA)	38,643
Ohio	10,057	4,608	2,893	1,353	934	269
Oregon[10]	25,807	21,946	2,438	1,018	(NA)	405
Rhode Island	1,974	1,065	418	141	24	326
West Virginia	994	(NA)	(NA)	(NA)	(NA)	994

Note: Because of rounding, detail may not add to totals.

[1]Values are as of January 1, 1979. [2]California values are limited to those amounts required to be enrolled. [3]Georgia values are as of January 1, 1978. [4]Idaho values are estimates as of 1977. "Other or unallocable" category includes $2,068 million in inventory and crops; $2,354 million in household goods; and $1,159 million in motor vehicles. [5]Kansas values are market rather than assessed values. [6]Michigan values are for 61 out of 83 counties and include partial reports for 5 of those 61 counties. If the reported data were projected statewide, there would be an estimated $31,200 million (at 50 percent of true cash value) in fully exempt property. [7]Minnesota values are market values as of January 1, 1980. [8]New Jersey governmental and educational values are combined under the governmental heading. [9]New York values do not reflect totally exempt property located in local assessing jurisdictions that did not report to the State. [10]Oregon values are true cash values rather than assessed values.

SOURCE: U.S. Department of Commerce, Bureau of the Census, Taxable Property Values and Assessment-Sales Price Ratios, Volume 2, (GPO: Washington, D.C.) 1983, p. XLVII.

partially exempt property are better representations of exempt values since the property from which they are derived is subjected to the same valuation process as is all other property in a state. Only after being valued by a tax official is a portion of the value exempted. Partial tax exemptions in the Bureau's report represent $120.7 billion in value for 31 States and the District of Columbia. The

$120.7 billion worth of value represents, on the average, 4.1% of the gross assessed value in those same states and the District.

TABLE 2

Assessed Value Removed from Tax Base for Selected States: 1981

(Dollar amounts in millions. For meaning of symbols, see text)

State	Exemptions				Total as percent of gross assessed value
	Total	Homestead	Veterans	Other and unallocable	
Total	120,726	(NA)	(NA)	(NA)	4.1
Alabama	1,801	1,595	-	206	19.7
California*	29,440	29,138	302	-	4.5
Connecticut*	476	(NA)	(NA)	476	1.0
Delaware	86	86	-	-	2.1
District of Columbia*	626	626	-	-	3.3
Florida	48,136	36,595	-	[1]11,542	19.3
Georgia	2,947	2,947	-	-	6.3
Hawaii*	2,279	2,235	-	44	11.2
Idaho*	1,274	1,133	-	[2]141	5.2
Illinois*	6,956	(NA)	-	6,956	8.4
Indiana	951	86	109	756	3.7
Kentucky	2,432	2,432	-	-	4.2
Louisiana	2,395	2,395	-	-	4.1
Maine*	118	-	116	2	11.6
Mississippi	1,160	1,160	-	-	21.9
Nebraska	1,251	1,251	-	-	3.4
Nevada*	26	(NA)	18	8	0.3
New Hampshire	153	135	-	18	4.3
New Jersey	60	-	-	60	0.1
New Mexico*	122	(NA)	82	40	2.2
New York*	7,373	(NA)	(NA)	7,373	8.8
North Carolina[3]	1,351	1,017	-	334	1.2
North Dakota*	7	7	-	-	0.8
Oklahoma*	788	681	(NA)	107	9.8
Oregon*	176	161	-	15	1.3
Rhode Island*	227	-	108	119	2.4
South Dakota*	109	-	-	109	2.9
Texas	6,088	(NA)	(NA)	6,088	4.9
Utah*	31	(NA)	(NA)	[4]31	0.5
Washington	1,306	966	-	340	3.0
West Virginia*	474	474	-	-	3.3
Wyoming	107	103	4	-	1.7

Note: Because of rounding, detail may not add to totals.

*Has circuit breaker; see text.

[1]Includes $11,187 million of exempted inventory differential. [2]Includes $110 million of exempted State-assessed value. [3]Data shown are for 66 out of 100 counties in North Carolina. [4]Includes $4 million of exempted State-assessed value.

SOURCE: U.S. Department of Commerce, Bureau of the Census, Taxable Property Values and Assessment-Sales Price Ratios, Volume 2, (GPO: Washington, D.C.), 1983, p. XLIX.

Various estimates have been offered that suggest the likely national ratio of exempt property to total property valuation. Estimates vary -- though usually in the range of 20% to 33% of total value. The International Association of Assessing Officers has estimated that the one-third ratio is the most likely. (Alfred Balk, The Free List: Property Without Taxes (New York, N.Y: Russell Sage Foundation, 1971), pp. 11-12.)]

Just as the total value of property tax exemptions is uncertain, so too is the exact shift of tax burden caused by exemptions. While there is no disagreement that the exemption of property from a tax base increases the tax level of property not exempted, it is harder to get consensus in any specific jurisdiction as to how burden is shifted. The California Legislature has done considerable work with the exemption issue. Its work is illustrated in a hypothetical tax bill (Table 3) attributable to property tax exemptions. The table illustrates the impact of tax exemptions on various properties.

TABLE 3

Estimated Yearly Tax Bill Attributable to Exemptions, California, for Four Hypothetical Taxpayers

Property and Market Value	Assessed Value	Total Tax Payment due to Exemptions	Payment due to			
			Veterans	Churches	Colleges	Welfare
$ 10,000	$ 2,330	$ 8.33	$ 5.48	$ 1.10	$ 0.51	$ 1.24
16,000	3,728	13.31	8.76	1.75	.82	1.98
40,000	9,320	33.27	21.90	4.38	2.05	4.94
100,000	23,330	83.30	54.83	10.97	5.13	12.37

SOURCE: Alfred Balk, The Free List: Property Without Taxes, (Russell Sage Foundation, New York, NY), 1971, p. 217; as cited in Jim Oppedahl, memo to the Revenue Oversight Committee, Legislative Council, Helena, Montana, May 21, 1984.

Selected Property Tax Exemptions in Montana

In the State of Montana charitable, educational, and religious property tax exemptions found their basis in the 1889 Montana Constitution. Article XII, section 2, provided:

> The property of the United States, the state, counties, cities, towns, school districts, municipal corporations and public libraries, shall be exempt from taxation; and such other property as may be used exclusively for the agricultural and horticultural societies, for educational purposes, places for actual religious worship, hospitals and places of burial not used or held for private or corporate profit, institutions of purely public charity and evidences of debt secured by mortgages of record upon real or personal property in the state of Montana, may be exempt from taxation. (Emphasis added.)

The 1972 Constitution did little to change the state's exemption policy. The delegates to the Constitutional Convention did, however, leave the Legislature with additional discretion to exempt property from taxation. They also specifically permitted taxation of private interests in government-owned property and assessment of special improvement district charges on tax exempt property. The relevant language of the 1972 Constitution on property tax exemptions reads:

> Section 5. Property tax exemptions. (1) The legislature may exempt from taxation:
>
> (a) Property of the United States, the state, counties, cities, towns, school districts, municipal corporations, and public libraries, but any private interest in such property may be taxed separately.
> (b) Institutions of purely public charity, hospitals and places of burial not used or held for private or corporate profit, places for actual religious worship, and property used exclusively for educational purposes.
> (c) Any other classes of property.

> (2) The legislature may authorize creation of special improvement districts for capital improvements and the maintenance thereof. It may authorize the assessment of charges for such improvements and maintenance against tax exempt property directly benefitted thereby. (Emphasis added.)

Debate on this provision during the Constitutional Convention revolved primarily around arguments about how much latitude to give the Legislature in exempting properties. The Convention decided to allow the Legislature complete discretion -- including the ability to tax federal property should the Congress allow such a practice in the future. The exemptions specifically listed in subsection (1) (b) were itemized in an effort to clarify "that regardless of the class of property, if they're owned by this charitable or governmental organization, the Legislature may exempt" such property from taxation. (Montana Constitutional Convention, Verbatim Transcript, Volume V, p. 1420 Statement by Delegate McDonough.)

Delegate McDonough emphasized in his testimony that the "main reason" for listing specific exemptions in the first two subsections of this section was to assure various organizations that "their status stayed the same as it was for the last 90 years." (Montana Constitutional Convention, Verbatim Transcript, Volume V, p. 1420)

Delegate McDonough's stated objective of maintaining the status quo was achieved by passage of the 1972 document. Today's Constitutional exemptions for institutions of purely public charity, places for actual religious worship, and property used exclusively for educational purposes have remained unchanged since statehood.

Legislative changes related to these particular exemptions have not changed much either. The Legislature has made two substantive changes in statute regarding these exemption

provisions. The first related to institutions of purely public charity. In the mid-1960's there was some question of whether a nonprofit organization that operated a facility for the retired, aged, or chronically ill qualified under the provision for an institution of purely public charity. The Legislature specifically included such institutions in the statutory definition of purely public charity. (Chapter 85, Laws of 1965.)

The second legislative change was made in 1975. In response to a memorandum from the Department of Revenue to County Assessors that directed placing parsonages on the tax roll, the Montana Association of Churches established a task force on tax exemption. House Bill 144 was introduced in the 1975 Session to resolve the dispute. As introduced, the bill's exemption provisions were very broad. The bill exempted parsonages along with other buildings and lands used for "religious purposes and for the usual and normal activities directly related to such religious purposes". Proponents argued that such exemption was merely continuing the status that such property had enjoyed since statehood. By the time the bill passed and was signed by the Governor, the exemption was limited to residences of the clergy and also restricted the amount of land that would qualify for exemption both for the place of actual worship and for the clerical residence. (Chapter 325, Laws of 1975.)

While legislative changes have been slight, so too have court challenges. There have been only a half dozen significant cases in Montana related to these exemptions. (See Flathead Lake Methodist Camp v. Webb, (144 M 565, 399 P2d 90 (1965)); NW. Improvement Co. v. Rosebud County, (129 M 412, 288 P2d 657 (1955)); Deaconess Foundation v. Ford, (151 M 143, 439 P2d 915, 37 ALR 3d 558 (1968)); Missions v. Lewis and Clark County, (13 M 559, 35 P 2 (1893)); and Cascade v. Cascade County (75 M 304, 243 P 806 (1926)).)

In general, the cases have settled the following points:

Educational Property

1. The purpose of exempting educational property is to promote and encourage the cause of education.

2. Religious education is exempt as an "educational purpose" and not as "an actual religious worship".

3. When a church summer camp is "used exclusively for educational purposes" it is exempt.

4. Ownership of property is of no importance; it is exempt if it is used exclusively for educational purposes.

5. Exemption status is dependent upon present and active use of qualifying property.

Institutions of Purely Public Charity

1. The fact that an institution charges a fee, imposes admission requirements that would tend to somewhat limit membership, or maintains a high standard of care for its clients does not disqualify it from receiving exemption status.

2. When exempting an institution of purely public charity, sufficient residence and recreation area may also be exempt.

A 1926 Montana case established the requirement that property tax exemption provisions of the Constitution and statutes must be strictly interpreted, while the 1965 case of Flathead Lake Methodist Camp v. Webb asserted a doctrine that each case had to be viewed from a realistic standpoint that considered individual factual situations. The latest Supreme Court case dealing with church exemptions has reiterated the balancing test between strict and liberal construction of exemption provisions. (Old Fashion Baptist Church v. Montana Dept of Revenue (40 St. Rep 1774 (1983)).)

Current Issues on Selected Property Tax Exemptions

The Department of Revenue began preliminary efforts to require County Assessors to channel applications for tax exemption through Helena in 1975. The program for state-level review of exemptions in Helena apparently was loosely applied until 1981. In the period from 1981 to 1983, the Department began a serious program of review and considered 657 requests for property tax exemption; 525 applications were approved, and 132 were denied. In 1984, approximately 550 applications were received prior to the Department's March 1 deadline for application.

Real property applications that are reviewed are for new properties only -- the review does not go back to examine exemptions that have been granted in the past. Personal property, such as motor vehicles, is being reviewed on a more comprehensive basis since owners must renew their registration each year.

Examples of organizations that have qualified since 1981 for property tax exemption under 15-6-209 (community service building exemption) include the Elks, Jaycees, Kiwanis, Masons, Moose, Sons of Norway Lodge, Lambert Historical Society (portion used for senior citizens), and the Vigilance Club of Virginia City. Under the provision for "purely public charity", organizations that have qualified are the Boy Scouts and Girl Scouts of America, Easter Seal Foundation, Flathead Valley Chemical Dependency Services, Poverello Center, Inc., and the Salvation Army.

The Department's review process has led to several court cases and appeals to the State Tax Appeal Board in the last year or so. Cases and appeals have involved questions of how to define "governmental", "educational", "purely public charity", and so forth.

In addition, questions have been raised about exemptions for church vehicles, exemptions for school busses owned and operated by private for-profit operators, the definition of "clergy", and the amount of land reasonably necessary for a place of actual religious worship.

Several of the questions seemed to have been answered either by the courts or the administrative appeals agency. The Supreme Court has settled, at least in one case, the issue of how much land is reasonably necessary near a place of actual religious worship. In doing so it seemed to have made a relatively strict interpretation of the Constitution and statutes by limiting the exemption to land immediately around the place of worship and absolutely necessary for ingress, egress, and actual use. By its strict interpretation, this case may also have settled the issued of whether other property owned by a church will enjoy exemption.

The State Tax Appeal Board (STAB) has reversed the Department of Revenue on the issue of quasi-governmental exemptions. The STAB allowed a tax exemption for a volunteer fire departments based on the fact that the governmental relationship between the fire district and the county was so close as to be nearly indistinguishable. Based on STAB's ruling, the Department now routinely grants exemption status to fire districts and other quasi-governmental districts, such as conservation districts, unified disposal districts, water user associations, and so forth.

The STAB has also reversed the Department in the area of what constitutes a "purely public charity" by allowing a halfway house in Billings to exempt a motor vehicle used in providing services to clients. The STAB relied upon more than half-a-dozen related criteria in making its decision that the halfway house was a purely public charity.

In its exemption review process the Department has routinely denied applications for exemption of motor vehicles based on church activities. The STAB has consistently upheld the Department in this area by noting that there is no basis in law for an exemption of general religious property.

Legislative Options to Clarify the Application of Property Tax Exemption Provisions

Property tax exemptions are now being granted and denied by the Department, STAB, and the courts based on a number of factors. Each of these entities relies on the wording of the relative statutes, an examination of previous Montana court decisions, the holdings of courts in other states in the absence of Montana decisions, and previous administrative rulings on exemption eligibility. The Department of Revenue has also implemented Property Assessment Division "policy" statements to clarify some of the ambiguities that arise in the property tax exemption area. Over time, a list of general criteria has been developed to test eligibility for exemption in a number of cases, but a number of grey areas remain for the consideration of the Legislature.

It appears that the Legislature has four broad options available to deal with problems that it may perceive in the exemption statutes. (The options are presented here to indicate the range of available legislative discretion. They do not represent recommendations.)

The first option available to the Legislature would be to eliminate all exemptions. This option would eliminate state government from the role of defining what constitutes "a place of worship", a "purely public charity", an "exclusive educational purpose", and so forth. Among other difficulties, this option would likely result in court challenges

based on first amendment cases that seem to call for "benevolent neutrality" in the taxation of religious activities.

The second option would be to do nothing. This option assumes that whatever exemption problems exist are not serious enough (in relation to factual questions or in fiscal impact on local governments) to merit legislative consideration -- or that the actual operation of existing administrative and legal mechanisms are working well enough to resolve current problems.

The third option would be to encourage or direct the Department of Revenue to adopt rules for administering exemption decisions. This option assumes that: (1) an adequate body of law -- in the form of constitutional and statutory provisions and administrative and court rulings -- exists to guide the Department in rulemaking; (2) the Department has adequate authority now to handle the problem with no intervention by the Legislature; and (3) public notice and hearings on such rules would assist administrators in clarifying their interpretation of the manner in which the law is to be administered. There are a number of suboptions within this option -- depending upon the level of formality desired.

On a relatively informal basis, the Revenue Oversight Committee could recommend to the Department that it adopt rules to clarify its application of exemption statutes. The Property Assessment Division already has both informal and formal "policies" in the exemption area that constitute "rules" which have not had the advantages of public comment or legal adoption. The Committee may also choose to exercise its authority under 5-18-107, MCA, to require that rulemaking hearings be held in accordance with the provisions of 2-4-302 through 2-4-305, MCA, on the exemption rules that have already been adopted by the Department.

On a more formal basis, a bill could be adopted directing the Department of Revenue to adopt rules for administering property tax exemptions. The bill would need to contain a fairly specific statement of legislative intent that would guide the rulemaking process.

The fourth option would be for the Committee to recommend a bill to the 1985 Legislature that would specifically define and/or limit the application of certain property tax exemption provisions. This option has both advantages and disadvantages, which are briefly examined below.

Defining such terms as "institutions of purely public charity" or "educational purposes" can be both difficult to actually accomplish and subject to substantial criticism. In fact, a satisfying and all-encompassing definition -- one that seems clear when applied against an actual case -- may be impossible to design. Further, new definitions may only add to the confusion and suffer from inconsistencies when eventually interpreted by administrative and legal bodies.

The Revenue Oversight Committee reviewed a list of various state's definitions of what "purely public charity" means. Most state statutes provide only general definitional guidance. The North Carolina definition, for example, defines a charitable purpose as having "humane and philanthropic objectives; it is an activity that benefits humanity or a significant rather than limited segment of the community. . . ." Many states statutes include statements about the charity being "wholly benevolent" and preventing the subjects of charity from becoming "burdensome to society or to the state". These statements appear to be aimed more at articulating a general state purpose than in actually defining a specific term. In Montana, a general statement of public purpose in granting property tax exemptions is

missing from many exemption statutes. Such a statement might add clarity to later interpretations and could emphasize the public policy that is to be achieved by granting an exemption.

Missing also are guidelines to administrators on how broadly or narrowly they are to interpret application of exemption provisions in a multitude of factual situations. Listed below are possible ways in which property tax exemptions -- particularly those related to both purely public charity and purely educational exemptions -- could be limited. Some of the provisions are found scattered throughout current Montana exemption law, some are found in other States, and some are part of the tests for federal income tax exemptions (Section 501 (C)(3)).

In order to receive property tax exemption, the Legislature could require that an organization or institution:

(1) serve a clearly public rather than a private interest;

(2) be both organized and operated exclusively for the purpose for which an exemption is given;

(3) be organized and operated on a not-for-profit basis;

(4) ensure that no part of the net earnings of the organization may inure to the benefit of any private shareholder or individual; and/or

(5) guarantee that its assets will be dedicated to an exempt purpose. Upon dissolution, such assets would be distributed for one or more exempt purposes, or to the federal, state, or local government.

The application of the property tax exemption statutes could also be restricted by:

(1) limiting the total value upon which any one organization or property could claim an exemption;

(2) limiting the total acres upon which an exemption could be claimed; and/or

(3) restricting property tax exemptions to property that is both owned by a qualifying organization and used for the exempt activity.

Committee Deliberations and Recommendations

As discussion evolved from this study, there were indications that no defects existed within Montana's property tax exemption provisions so glaring that sweeping changes were necessary. This was evidenced in two ways.

First, staff research indicated that only half-a-dozen significant exemption cases have been litigated in Montana in the State's 95-year history. The conclusion reached by the Committee, based on this lack of conflict, was that the State's exemption provisions were not too restrictive nor too generous.

Second, testimony given by numerous interested parties indicated that existing statutory provisions were acceptable and not in need of revision, especially revisions that could result in changes in the property tax status quo. It was emphasized that the effect of eliminating property tax exemptions could, in relative terms, be far more damaging to those granted the exemptions than the elimination would be beneficial to those not exempted.

Upon several probing questions by the Committee's members of Department of Revenue personnel and State Tax Appeal Board members, it further became evident that property tax

exemptions were not causing insurmountable problems. In answer to a Committee member's question, "Does the Department have a pretty good handle on the administration of the exemption statutes now?", the reply from the administrator of the Property Tax Division was, "We are not as far as we would like to be, but by the end of 1985 we will be."

The result of the Committee's findings on property tax exemptions was somewhat anachronistic: a motion was adopted that the Revenue Oversight Committee defer any further consideration of property tax exemptions until 1986 -- with the exception of church-owned passenger vehicles.

This exception was the result of testimony from Department personnel, local officials, and Committee members themselves of repeated requests that the statutes be clarified, and if necessary revised, to provide that property tax exemption be extended to church-owned passenger vehicles.

There was some concern on the part of the Committee, the Department, and local officials of what consitituted a "passenger vehicle", and whether some type of a use as well as an ownership test, might not be preferable. In the final analysis, it became apparent once again that problems with the proposed vehicle exemption would be minimal.

Consequently, the Committee requested that a bill be drafted revising Montana's exemption statute, 15-6-201, MCA, to include church-owned passenger vehicles. The Committee's staff developed LC 0058 for the August 24-25 meeting at which the draft legislation was adopted by the Committee for recommendation to the 49th Legislature. A copy of LC 0058 is included as Appendix B.

Introduction

The Committee's staff prepared two reports for this element of the study. The first report was presented to the Committee in November of 1983. It was titled "SJR 23 -- Study of Property and Income Tax Exemptions, Exclusions, Deductions, Etc." The second report, "Update on SJR 23", was presented to the Committee in September of 1984 and was but a brief review of the first report, with some expansion on its contents.

A Caveat From the Committee

During the Committee's final discussion of income tax deductions, exclusions, and credits, a question arose as to the validity of some of the figures presented in the reports and memoranda. Specifically, where terms like "foregone revenue" or "revenue losses" were used by the staff or the Department of Revenue, the Committee agreed that the incidence of these property tax adjustments simply could not be known. For every source referring to the adjustments as a "revenue loss" or "tax expenditure", a similar but contrary source could be produced indicating the net effect of the adjustments could result in a revenue increase over time. In deference to this position, all references to "revenue losses", etc., should be viewed as specious facts, not necessarily as ultimate tax truths.

More on Property Tax Exemptions

With respect to property tax exemptions, the staff identified more than a dozen Montana Code Annotated (MCA)

sections affecting more than 50 different kinds of property. (See Appendix A.) In addition, four code section were identified granting property tax reductions, and one section was mentioned granting property tax deferral to persons on active military service. (Jim Oppedahl, "SJR 31 -- Study of Property and Income Tax Exemptions, Exclusions, Deductions, Etc.", memorandum to the Revenue Oversight Committee, Montana Legislative Council, Helena, Montana, November 7, 1983.)

A Department of Revenue memorandum accompanied this report, in which four different exemptions were discussed: the nonfossil energy exemption, the nonprofit institution exemption, the new industry real property exemption, and the remodeling exemption. (Steve Bender, Montana Department of Revenue, memo to Terry Cohea, November 1, 1983.)

The nonfossil energy exemption resulted in a maximum of $66,690 in foregone property tax revenue. The Department's memo considered this potential revenue loss, even at the maximum estimated, as insignificant.

The new industry real property exemption apparently has even less effect than the nonfossil energy exemption. As of November 1, 1983, there were no facilities receiving benefits from this exemption.

The exemption for remodeling projects has been authorized in four counties. The Department's November 1, 1983, memo listed revenue losses resulting from this exemption to Cascade County at $1,169, to Glacier County at $1,459, and to Lewis and Clark County at $138,210.

The property tax exemption granted to certain nonprofit properties (referred to in the Bender memo as "nonprofit institutions) seems to have a significant effect on property tax revenues. The property exempted in this category includes government-owned property, church property, and educational property, among others. Although the Department could not estimate the total effect of this exemption, the 468 properties exempted between 1980 and November 1983 resulted in about $2.2 million in revenue losses annually. According to the Department, "this represents only a small portion of the revenue loss."

Regarding personal income taxes, the staff's November 1983 report included some Department of Revenue estimates on the revenue implications of exclusions, deductions, exemptions, and credits. A few tables are included here for illustrative purposes.

TABLE 4

IMPLICATIONS TO MONTANA INCOME TAX REVENUES DUE TO EXCLUSIONS, DEDUCTIONS, PERSONAL EXEMPTIONS AND CREDITS

Type of Reduction	Income Tax Revenue Foregone	% of Total Tax Reduction
Federal Exclusions	$ 52,557,101	21.01%
Additional Montana Exclusions	32,392,974	12.95
Deductions	117,150,937	46.83
Personal Exemptions	36,850,414	14.73
Credits	11,200,362	4.48

SOURCE: Terry Cohea to Jim Oppedahl, memorandum, October 24, 1983, Montana Department of Revenue; as cited in Oppedahl, November 1983.

TABLE 5

SELECTED DATA ON MONTANA INCOME TAX CREDITS

Type of Credit	Number of Tax Returns	Credit Claimed
Taxes paid to other states or countries	3,695	$ 911,162
Contractor's gross receipt tax	97	44,446
Investment credit	36,641	7,859,676
Recapture	6,444	(655,021)
Homeowners/renters credit	15,428	1,837,821
Business inventory credit	1,850	593,092
Non-fossil energy credit	999	82,859
Energy conservation credit	13,899	526,327

SOURCE: Terry Cohea to Jim Oppedahl, memorandum, October 24, 1983, Montana Department of Revenue; as cited in Oppedahl, November 1983.

TABLE 6

SELECTED DATA ON INCOME TAX CREDITS
BY TAXABLE INCOME BRACKET

Taxable Income Bracket	Energy Conservation		Nonfossil Energy		Elderly Homeowner Credit	
	Returns	Avg. Credit	Returns	Avg. Credit	Returns	Avg. Credit
$ 0-$1,100	554	$30.40	42	$ 69.17	12,184	$122
1,101- 2,200	561	27.15	49	120.78	1,271	109
2,201- 4,400	1,217	33.94	86	64.24	1,261	108
4,401- 6,600	1,434	35.78	98	62.39	395	107
6,601- 8,800	1,683	32.58	108	80.89	158	110
8,801-11,000	1,867	34.40	137	60.01	72	115
11,001-15,300	3,062	35.43	198	86.65	54	121
15,301-21,900	2,281	43.11	166	99.49	26	123
21,901-38,400	1,032	53.96	89	123.57	7	89
38,400 +	208	96.53	26	144.96	--	--
Totals	13,899	526,327	999	82,859	15,428	119

SOURCE: Terry Cohea to Jim Oppedahl, memorandum, October 24, 1983, Montana Department of Revenue; as cited in Oppedahl, November 1983.

TABLE 7

SELECTED DATA ON THE INVESTMENT TAX CREDIT

Taxable Income Bracket	Returns Claiming	Average Credit
0- 1,000	1,998	$ 49.05
1,100- 2,200	2,347	35.21
2,200- 4,400	5,019	66.62
4,400- 6,600	4,621	111.89
6,600- 8,800	4,178	138.34
8,800-11,000	3,519	167.32
11,000-15,300	5,103	204.59
15,300-21,900	4,231	296.99
21,900-38,400	3,215	480.74
38,400 +	1,350	1,023.60
	35,581	$7,426,859*

SOURCE: Terry Cohea to Jim Oppedahl, memorandum, October 27, 1983, Montana Department of Revenue; as cited in Oppedahl, November 1983.

New Information on Corporation Exclusions, Credits, Deductions, Etc.

The Department of Revenue has recently compiled some additional information on corporation tax reduction mechanisms in August of 1984. These mechanisms include federal tax deferrals and credits, and income exclusions and deductions. Additionally, Montana-related tax credit information has also been compiled. Larry Finch with the Department of Revenue's Research Bureau cautions that

> . . . the estimates of federal-related tax expenditures represent a rough, best guess at state level revenue losses. Nevertheless, the estimates should provide insight into those areas where relatively large and small revenue losses occur.

The information contained in Table 8 indicates the estimated revenue loss accruing from four credits available to corporations in Montana.

TABLE 8

ESTIMATED REVENUE LOSS
RESULTING FROM FOUR MONTANA TAX CREDITS

Type of Credit	Estimated Revenue Loss
Investment Credit	$ 2,999,103
Contractor's Gross Receipts Tax Credit	400,000
New Industry Credit	10,000
Interest Differential Credit	261,000
TOTAL	$ 3,670,864

SOURCE: Larry Finch, Montana Department of Revenue, memo to Dave Bohyer, September 18, 1984.

The Department of Revenue's research staff also developed a document titled "Fact Sheet on Montana's Corporation Taxes" in January of 1984. (The Fact Sheet is attached as Appendix C.) Several items discussed in the fact sheet are listed below.

1. In FY 1982, 874 corporations claimed business inventory credits totalling $1,710,615. In FY 1983, the numbers had changed to 1,834 corporations claiming credits of $5,727,503.

2. In FY 1983, 55% of the total amount claimed under the business inventory credit ($3,150,000+) was claimed by fewer than 5% of the corporations claiming the credit.

3. In FY 1983, over 53% of the total amount claimed under the investment credit was claimed by fewer than 6% of the corporations claiming the credit.

4. About 1% of the state's corporate taxpayers accounted for over 57% of the state's corporate tax revenue.

5. Montana's adoption of the Accelerated Cost Recovery System (ACRS) will save businesses about $19 million in Montana corporation taxes in the 1984-85 biennium.

TABLE 9

ESTIMATED MONTANA TAX REVENUE LOSS
FROM SELECTED FEDERAL TAX REDUCTION MECHANISMS

Type of Reduction	Estimated Revenue Loss	
	FY 1983	FY 1984
Deferral of Income of Domestic International Sales Corporation (DISC)	$ 536,000	$ 457,700
Expensing of research and development expenditures	836,100	915,300
Exclusion of interest on State and local government pollution control bonds	347,600	395,900
Exclusion of interest on State and local government industrial development bonds	909,500	1,077,500
Tax Credit for Employee Stock Option Plans (ESOP)	482,800	531,000
Exclusion of interest on State and local government hospital bonds	307,000	370,800
Accelerated depreciation (ACRS)*	4,900,000	7,400,000

SOURCES: "Estimates of Federal Tax Expenditures for Fiscal Years 1983-1988" by the staff of the Joint Committee on Taxation, March 7, 1983, U.S. GPO, Washington, D.C.; as cited in Larry Finch, Montana Dept. of Revenue, memo to Dave Bohyer, September 18, 1984. * From letter to Governor Schwinden from Citizens for Tax Justice, April 18, 1983.

Conclusions and Recommendation

With respect to income tax deductions, exclusions, exemptions, and credits, the only conclusion that the Committee could reach was that most of the questions posed in Senate Joint Resolution 23 could not be answered with certainty.

The costs and benefits could not be determined with any degree of reliability due to incidence factors and to secondary, tertiary, etc., effects of the adjustments. For the same reasons, the ultimate beneficiaries could not be identified.

While the purpose of some of the adjustments can be traced to enacting legislation, public hearings, or committee deliberations, the purported purpose of others was either never stated, has been lost, or is otherwise unknown. And even in the cases where the purpose can be found, the difficulty or inability to determine the costs and benefits results in an attendant inability to determine the effectiveness of the stated purpose.

The frustration of the Committee members is evidenced not only by the caveat stated at the beginning of this part, but as well in the motion adopted by the Committee. The motion was simply that the information compiled and reports developed under Senate Joint Resolution 23 be "properly indexed and filed." No further recommendation was made.

TABLE 1

TAX EXEMPTIONS AVAILABLE IN THE STATE OF MONTANA
AND THE ESTIMATED REVENUE IMPACT OF EACH

PROPERTY TAXES

MCA Citation	CATEGORY OF TAX EXEMPTION	Year Granted	Est. Yearly Impact ($ 000)
	EXEMPTIONS:		
	Public Property:		
15-6-201	Federal Property	NA	NA
15-6-201	State Property		
15-6-201	County Property		
15-6-201	Property of Cities and Towns		
15-6-201	Municipal Corporations		
15-36-101	Oil and Gas Interests of Governmental Entities		
15-6-201	Public Schools: Colleges and Universities Kindergarten through 12		
15-6-201	Public Libraries		
67-10-301	Airports owned by municipality but outside of the territorial limits of that municipality		
67-10-406	Airports Owned by By Municipal Corporations in Adjoining States (Optional)		
67-11-306	Airport Authority		
15-6-201	Public Right-of-Way Easements		
76-15-404	Conservation Districts		
15-6-141	Electric Transmission Facilities Congressionally Created		
	Private Property:	NA	NA
15-6-206	Churches, Parsonages, and Adjacent Grounds		
32-3-901	Credit Unions		
15-6-201	Libraries		
15-6-201	Agricultural Societies		
15-6-201	Horticultural Societies		
15-6-201	Educational		
15-6-201	Hospitals		

15-6-201	Non-Profit Organizations: Irrigation Districts Cemetaries Domestic Water Distribution Cooperatives	NA	NA
15-6-201	Institutions of Purely Public Charity: Homes for Retired or Aged Nursing Homes, etc.	NA	NA
		ALL	
15-6-201	Mortgage-secured Indebtedness	NA	NA
15-6-201	Art Galleries Open to Public		
15-6-201	Observatories Open to Public		
15-6-201	Household Goods and Furniture		
15-6-201	Truck Canopy Cover Under 300 lbs.		
15-6-201	Mopeds		
15-6-201	Automobiles and Trucks under 3/4 Ton		
15-6-201	Right of Entry		
15-6-201	Facilities for Care of Developmentally Disabled, Mentally Ill, Vocationally Handicapped		
33-7-407	Fraternal Benefit Societies (not exempt from taxes on real estate and furniture)		
15-6-201	Energy Generation Facilities: Single Family Residential Multifamily or Nonresidential		
15-6-202	Freeport Merchandise		
15-6-202	Business Inventories		
15-6-203	Veterans' Clubhouse		
15-6-203	Incompetent Veterans' Trusts		
15-6-204	Moneys and Credits		
15-6-206	Irrigation and Drainage facilities		
15-6-206	Sprinkler Irrigation Systems		
15-6-207	Agricultural Products: Unprocessed, perishable fruits and vegetables in farm storage and owned by producer Nonperishable unprocessed agricultural products held in possess of original owner less than 7 months following harvest Livestock which have not attained the age of 9 months Swine which have not attained the age of 3 months		
15-6-208	Mineral production: One-half of contract sales price of coal from coal producer who produces less		

	than 50,000 tons per year		
	One-half of merchantable value of metal mines producing less than 20,000 tons of ore per year		
15-23-612	One-half of the value of net proceeds on natural gas for deep wells for 3 years		
15-6-209	Community Service Buildings		
15-6-210	Antique Aircraft		
15-6-211	Totally Disabled Veteran Residences		
15-24-301	Agricultural Harvesting Machinery Licensed in Other States		
	DEFERRALS:	NA	NA
10-1-606	Persons on Active Military Service		
	REDUCTIONS:	NA	NA
15-16-611	Property Destroyed by Natural Disaster		
15-24-1307, 15-24-1402, 15-24-1501	Commercial and Industrial Construction, Expansion, and Remodeling Variable Rates after Construction Begins (temporary)		

TABLE 2
TAX EXEMPTIONS AVAILABLE IN THE STATE OF MONTANA
AND THE ESTIMATED REVENUE IMPACT OF EACH

INDIVIDUAL INCOME TAXES

MCA Citation	INDIVIDUAL INCOME TAXES	Year Granted	Est. 1981 Impact
	EXEMPTIONS: $36,850,414		
15-30-112	Personal		N/A
	Regular		N/A
	65 or Over		N/A
	Blind		N/A
15-30-112	Dependents		N/A
15-30-114	Handicapped Children		N/A
	REDUCTIONS OF INCOME: $42,194,369		
15-30-111	Private Retirement Income		171,652
15-30-111	Interest Exclusion for Elderly		3,436,967
15-30-131	Income from Sources Outside MT (Part-year & Nonresidents Only)		31,214,086
15-30-111	Exempt Retirement Income		2,597,068
15-30-111	State Refund		911,845
15-30-111	Other		3,862,751
	DEDUCTIONS: $117,150,937		
15-30-122	Standard Deduction		6,534,900
15-30-121	Contributions		6,560,802
15-30-121	Interest Expense		23,638,589

15-30-121	Federal Income Tax	62,501,689
15-30-121	Other Taxes	7,388,158
15-30-121	Medical Expense	5,334,941
15-30-121	Child and Dependent Care Expense	181,523
15-30-121	Casualty or Theft Loss	891,610
15-30-121	Other Deductions:	4,118,725

CREDITS: $11,200,362

15-30-124	Income Taxes Paid Other States or Countries (F 2A, line 78)	911,162
15-50-207	Contractors Gross Receipts (F 2A, line 79)	44,446
15-30-162	Investment [minus recapture] (F 2A, line 80)	7,204,655
15-32-109	Non-fossil Energy Systems (F 2A, line 81)	82,859
15-30-125	Energy Conservation Installations (F 2A, line 82)	526,327
15-30-176	Elderly Homeowner or Renter (F 2EC)	1,837,821
Ch. 613 Laws of 1981	Business Inventory	593,092

_____ BILL NO. _____

INTRODUCED BY _____

BY REQUEST OF THE REVENUE OVERSIGHT COMMITTEE

A BILL FOR AN ACT ENTITLED: "AN ACT EXEMPTING CHURCH-OWNED PASSENGER VEHICLES FROM TAXATION AND LICENSE FEES; AMENDING SECTIONS 15-6-201 AND 61-3-532, MCA."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 15-6-201, MCA, is amended to read:

"15-6-201. Exempt categories. (1) The following categories of property are exempt from taxation:

(a) the property of:

(i) the United States, the state, counties, cities, towns, school districts;

(ii) irrigation districts organized under the laws of Montana and not operating for profit;

(iii) municipal corporations; and

(iv) public libraries;

(b) (i) buildings, with land they occupy and furnishings therein, owned by a church and used for actual religious worship or for residences of the clergy, together with adjacent land reasonably necessary for convenient use of such buildings; and

(ii) passenger vehicles, limited to light vehicles as

defined in 61-3-531 and buses or other motor vehicles designed for carrying more than six passengers and used for the transportation of persons, when such vehicles are owned by a church and used for religious purposes;

(c) property used exclusively for agricultural and horticultural societies, for educational purposes, and for hospitals;

(d) property that meets the following conditions:

(i) is owned and held by any association or corporation organized under Title 35, chapter 2, 3, 20, or 21;

(ii) is devoted exclusively to use in connection with a cemetery or cemeteries for which a permanent care and improvement fund has been established as provided for in Title 35, chapter 20, part 3; and

(iii) is not maintained and operated for private or corporate profit;

(e) institutions of purely public charity;

(f) evidence of debt secured by mortgages of record upon real or personal property in the state of Montana;

(g) public art galleries and public observatories not used or held for private or corporate profit;

(h) all household goods and furniture, including but not limited to clocks, musical instruments, sewing machines, and wearing apparel of members of the family, used by the owner for personal and domestic purposes or for furnishing or

equipping the family residence;

(i) a truck canopy cover or topper weighing less than 300 pounds and having no accommodations attached. Such property is also exempt from the fee in lieu of tax.

(j) a bicycle, as defined in 61-1-123, used by the owner for personal transportation purposes;

(k) automobiles and trucks having a rated capacity of three-quarters of a ton or less;

(l) fixtures, buildings, and improvements owned by a cooperative association or nonprofit corporation organized to furnish potable water to its members or customers for uses other than the irrigation of agricultural land;

(m) the right of entry that is a property right reserved in land or received by mesne conveyance (exclusive of leasehold interests), devise, or succession to enter land whose surface title is held by another to explore, prospect, or dig for oil, gas, coal, or minerals; and

(n) property owned and used by a corporation or association organized and operated exclusively for the care of the developmentally disabled, mentally ill, or vocationally handicapped as defined in 18-5-101, which is not operated for gain or profit.

(2) (a) The term "institutions of purely public charity" includes organizations owning and operating facilities for the care of the retired or aged or chronically ill, which

are not operated for gain or profit.

(b) The terms "public art galleries" and "public observatories" include only those art galleries and observatories, whether of public or private ownership, that are open to the public without charge at all reasonable hours and are used for the purpose of education only.

(3) The following portions of the appraised value of a capital investment made after January 1, 1979, in a recognized nonfossil form of energy generation, as defined in 15-32-102, are exempt from taxation for a period of 10 years following installation of the property:

(a) $20,000 in the case of a single-family residential dwelling;

(b) $100,000 in the case of a multifamily residential dwelling or a nonresidential structure."

Section 2. Section 61-3-532, MCA, is amended to read:

"61-3-532. Light vehicle license fee. (1) Except as provided in subsection (2), light vehicles are subject to a license fee. This fee is imposed in lieu of a property tax and is in addition to the tax on new motor vehicles.

(2) (a) Light vehicles that meet the description of property exempt from taxation under the provisions of subsections (a), (b)(ii), (c), (d), or (e) of 15-6-201(1) or 15-6-203(2) are exempt from the fee imposed in subsection (1) of this section.

(b) A dealer for light vehicles is not required to pay the license fee for light vehicles held for sale or used in the dealer's business in selling or demonstrating the vehicles. Vehicles exempt under this subsection may not be used for the personal use of the dealer, his family, or employees or for any use not necessary in the pursuit of business."

NEW SECTION. Section 3. Extension of authority. Any existing authority of the department of revenue to make rules on the provisions of this act is extended to the provisions of this act.

-End-

January 10, 1984

FACT SHEET ON MONTANA'S
CORPORATION TAXES

I. COLLECTION AND DISTRIBUTION

While corporation license tax ranks fifth among Montana's taxes in revenue production, its relative importance to total state revenue has declined in recent years:

	Total Collections	% of Total State Revenue
FY73	$12,057,255	2.83%
FY74	15,736,160	3.34
FY75	22,078,580	4.24
FY76	23,020,112	3.56
FY77	24,957,238	3.45
FY78	29,238,772	3.77
FY79	36,092,417	4.10
FY80	45,623,189	4.51
FY81	52,900,964	4.68
FY82	44,630,472	3.73
FY83	35,824,951	2.82

The corporation license tax collected from banks and savings associations is distributed 80% to the various taxing jurisdictions within the county in which the financial institution is located, 12.8% to the state general fund, 5% to the school foundation program, and 2.2% to the long-range building program. Corporation tax collected from other corporations is distributed 64% to the general fund, 25% to the school foundation programs, and 11% to the long range building program.*

II. DESCRIPTION OF TAX

A. Imposition of the tax

All corporations engaged in business for financial gain in Montana are subject to the corporate license tax.**

* If there are sufficient funds from other sources to fund the long-range building program, the corporation tax revenue is transferred to the general fund.

** A very small number of corporations are subject to Montana's corporate income tax, rather than the corporate license tax, because of the limited scope of their activity in the state. Deductions, credits, tax rate, and administration are the same for both taxes. No corporation is subject to both taxes.

Many non-profit educational, fraternal, religious, and marketing cooperative associations are exempt from paying the tax. However, any unrelated business income earned by an exempt corporation is taxable if it results in a federal tax liability of more than $100.

Corporations that have sales of tangible property in Montana but are domiciled elsewhere and do not own or rent real property within the state may elect to pay an alternate tax of 0.5% of gross sales made in Montana. Very few corporations choose this alternative.

Banks and savings and loan associations are treated for corporation tax purposes the same as other corporations, but 80% of the tax they pay is returned to the counties in which the bank or savings and loan association is located. This allocation was designed to reimburse local governments for revenue lost when the property tax on bank shares was repealed in 1979. The amount of corporation tax distributed to local governments since 1979 has been:

FY80	$3,969,413
FY81	4,521,660
FY82	3,639,179
FY83	3,434,493

However, these amounts may be reduced because of pending refund claims resulting from a 1982 Montana Supreme Court decision and legislation enacted by the 1983 legislature. The refunds for the period FY80 through FY83 may total $2.6 million, of which $2.0 million would have to be refunded by local governments. If the 1983 legislation is held invalid as a result of a recently filed lawsuit, local governments may have to refund $7.06 million to financial institutions for the period FY80 through FY83.

B. Tax base and rate

Montana's corporate tax rate is 6 3/4% of net income (gross income minus allowable deductions). Gross income is the same as for federal corporate taxes. Allowable deductions include all ordinary and necessary business expenses, certain losses and depreciation of assets, resource depletion allowance, interest paid on business debts, taxes paid (except state or federal corporation taxes), certain charitable contributions, certain energy-related investments, and net operating losses. Net operating losses may be carried back three years and carried forward seven years.

C. Apportionment of income

In FY83, 20% of all corporation tax returns were filed by corporations conducting a "unitary business" in more than one state. The amount of a multi-state corporation's total income that is subject to Montana tax is determined by a three factor formula based on the ratio of property, payroll, and sales in Montana to the corporation's total property, payroll, and sales. The same formula is used by more than 25 states. The use of the formula is designed to ensure that a corporation is taxed only on the income that is properly attributable to economic activity within the state.

D. Tax credits

Under Montana law, corporations are allowed to reduce their corporate tax liability by claiming tax credits for certain expenses. In FY83, corporations claimed $9 million in credits and reduced their tax liability by almost 20%. The five credits allowed are discussed below.

Business Inventory Credit. For tax years 1981 and 1982, corporations were allowed to claim as an income or corporate tax credit the amount paid to county treasurers for business inventory property tax (provided the tax had not been claimed as a deduction). Beginning in 1983, business inventories are exempt from property taxation.

In FY82, 874 corporations claimed business inventory credits totalling $1,710,615. The amount of credit claimed in FY83 was substantially higher: $5,727,503 claimed by 1,834 corporations.

As shown in the following table, most corporations claimed business inventory credits of less than $1,000 in FY83. However, eighty corporations claimed over $10,000 in inventory credit and six corporations claimed over $150,000. In other words, over 55% of the total amount of credit was claimed by fewer than 5% of the corporations claiming the credit. The largest credit claimed by a corporation was $256,370.

Business Inventory Credit Claimed	Number of Returns Claiming Credit	% of Total Returns Claiming Credit	% of Total Dollars of Credit Claimed
$ 1- 100	238	13.0%	.2
101- 500	439	23.9	1.6
501- 1,000	341	18.6	4.4
1,001- 2,000	314	17.1	7.7
2,001- 5,000	309	16.9	17.1
5,001- 10,000	113	6.2	13.7
10,001- 50,000	63	3.4	22.0
50,001-100,000	11	0.6	13.2
100,001-200,000	4	0.2	11.6
over 200,000	2	0.1	8.5
Total	1,834	100.0	100.0

Investment credit. Since 1977, corporations have been allowed to take a credit for a portion of the federal credit claimed for investment in depreciable property. Montana law allowed 20% of the federal credit to be claimed for tax years 1977 through 1980 and 30% for tax years 1981 and 1982. The 1983 legislature limited the credit to 5% of the federal credit up to $500 and required that the property for which the credit was claimed be used in Montana for the production of Montana income. The amount of investment credit claimed has grown rapidly since 1977:

	Number of Corporations Claiming	Total Amount Claimed
FY77	619	$ 123,403
FY78	1,366	865,489
FY79	3,615	1,366,569
FY80	4,172	1,653,769
FY81	4,276	2,220,603
FY82	5,140	2,995,634
FY83	5,773	2,999,103

In both FY82 and FY83, nearly 80% of the corporations claiming the credit claimed $500 or less. In 1983, only twenty-one corporations claimed investment credits in excess of $10,000, but 29 percent of the total amount of credit are claimed by less than 2 percent of the corporations claiming the credit. The largest credit claimed was $51,084.

Investment Credit Claimed	Number of Returns Claiming Credit	% of Total Returns Claiming Credit	% of Total Dollars of Credit Claimed
$ 1- 100	3,253	56.3	4.7
101- 500	1,272	22.0	11.0
501- 1,000	541	9.4	13.1
1,001- 2,000	369	6.4	17.5
2,001- 5,000	248	4.3	24.9
5,001- 10,000	69	1.2	15.3
over 10,000	21	.4	13.5
Total	5,773	100.0	100.0

Contractors's gross receipt tax credit. Corporations may claim as a credit against corporate taxes the amount of public contractors gross receipts tax paid. In FY83, 107 corporations claimed $400,000 in credits.

New industry credit. Certain new or expanding manufacturing corporations may claim a credit of 1% of total wages paid to new employees hired in the first three years after operation or expansion began. In FY83, fewer than ten corporations claimed this credit, totalling less than $10,000.

Interest differential. Public utilities and financial institutions that make low-interest loans to homeowners for energy conservation projects may claim a credit for the difference between the interest received on the loan and the interest they would have received at the prevailing rate. Public utilities may use the credit to offset their electrical energy tax. In FY83, $261,761 was claimed under this provision. Only one corporation claimed the credit against its corporation tax liability in FY83.

III. COMPARING MONTANA'S AND OTHER STATES' CORPORATE TAXES

A. Most corporations pay less than $500 per year in Montana corporate tax. For most corporations doing business in the state, Montana's corporation tax is an insignificant cost. An analysis of tax returns filed in FY83 showed that 10,618 corporations (70% of all those filing) paid $500 or less, with almost 40% paying $100 or less. A few large firms pay most of the tax. In FY83, 53 corporations paid 39% of the total corporate license tax collected.

FY83 Average Corporation Tax
Paid By Regular Corporations*

Average Tax Paid	No. of Returns	% of Total Returns	% of Total Tax Paid
$0	2,943	19.4%	-
$ 1- 100	3,079	20.3	.5
101- 500	4,596	30.4	2.6
501- 1,000	1,301	8.6	2.4
1,001- 2,000	1,402	9.3	4.2
2,001- 5,000	1,235	8.2	12.3
5,001- 20,000	285	1.9	10.6
20,001- 50,000	137	0.9	10.2
50,001-100,000	105	0.7	17.8
over 100,000	53	0.3	39.4
Total	15,136	100.0	100.0

B. Montana's corporate tax rate is lower than in 22 other states and has not been increased in the last ten years. Twenty-two states have higher corporate tax rates than Montana. For example, Minnesota's maximum rate is 12%, Connecticut's 11.5%, California's 9.6% and Alaska's 9.4%.

Montana's corporate tax rate has not been increased since 1973. In contrast, 23 of the 45 states imposing corporate taxes have raised their rates since 1977. In 1983 alone, 11 states increased their rates to help balance strained budgets. Five of these increases were enacted on a temporary basis. Wisconsin extended its 10% surtax for 1982 and 1983. North Dakota increased its maximum tax rate from 7% to 10.5% for three years. Utah raised its corporate franchise tax from 4% to 4.65% for 1983. Rhode Island's maximum rate is 9% for the current tax year. New Hampshire imposed a 19.5% surtax for FY84 and a 13.5% surtax for FY85. West Virginia imposed a 15% surtax for FY84, but increased its tax rate permanently. In the remaining states, the increases are considered permanent.

In addition, six states enacted legislation in 1983 requiring estimated payments of corporate income tax prior to their due dates or accelerated payment dates for corporate taxes.

* In addition, 3165 small business corporations paid $28,090 ($8.88 average payment) and 3 cooperatives paid $50 ($16.66 average payment).

C. Montana adopted the federal Accelerated Cost Recovery System (ACRS) and has enacted many other features attractive to the business community. Montana is one of 20 states that allow businesses to make full use of the new depreciation rules enacted in the federal Economic Tax Recovery Act of 1981 in calculating their state corporation tax. Adoption of ACRS will save businesses approximately $19 million in Montana corporation taxes in the 1984-85 biennium.

Many states do not allow full use of ACRS or require an addback of a portion of the ACRS deduction claimed. Since 1981, eight states have passed legislation denying or limiting the use of ACRS. Nine other states have enacted addback provisions.

Montana also allows corporations to use net operating losses in excess of the current year's tax liability to reduce taxes paid for the last three years or seven years in the future. Some states (like California, Michigan, New Hampshire, New Jersey, and Alabama) do not allow any net operating loss carryover. Other states limit carryovers to a much shorter period than Montana.

Another important deduction in a natural resource extraction state like Montana is the deduction allowed for federal windfall profit tax paid. In FY82, Montana oil producers paid $265.54 million in windfall profit tax. Some states do not allow this deduction.

Montana allows tax credits for a variety of business expenditures. In FY83, these credits enabled corporations to reduce their tax liability by over 20%.

CHAPTER SIX

MISCELLANEOUS COMMITTEE ACTIVITIES

INTRODUCTION

In addition to the study resolutions requiring the Committee's attention, there were several other issues which demanded examination. Among those were the recommendation of the Joint Interim Subcommittee on Agricultural Land Taxation; a number of liquor-related issues; and a request for a statutory change from a group of Glendive, Montana, area residents. This section presents a discussion of the Committee's examination and recommendation of each of these items.

AGRICULTURAL LAND TAXATION

Background

In addition to the study resolutions discussed previously in this report, the 48th Legislature adopted several other study resolutions. One of these was House Joint Resolution 35, a resolution requesting that an appropriate interim committee examine the status of the agricultural economy in Montana and the level of taxation on agricultural land. Before this study was assigned to an interim committee, the Revenue Oversight Committee expressed an interest in carrying out the study called for in the Resolution as it pertained generally as a tax matter to the responsibilities of the Committee. At the May 26, 1983, Committee meeting, a motion to request that the HJR 35 study be assigned to the Revenue Oversight Committee passed unanimously.

However, in its deliberations over the assignment of interim studies, the Legislative Council decided to appoint the Joint Interim Subcommittee on Agricultural Land Taxation to conduct the study called for in HJR 35. The membership of this Subcommittee was chosen from the House and Senate Committees on Agriculture and Taxation.

The Subcommittee organized in July of 1983 and began its work immediately. In addition to adopting a study plan outlining the examination of agricultural land taxation issues listed in the Resolution, the Subcommittee agreed to work closely with the Revenue Oversight Committee and another group, the Advisory Council on Agricultural Land Valuation, which was studying a closely related issue; i.e., agricultural land valuation.

Activities of the Interim Subcommittee

The Subcommittee met in September and again in December of 1983. At these two meetings the Subcommittee was briefed on the Department of Revenue's efforts at developing updated land valuation schedules to be adopted and applied as part of the statutorily required cyclical revaluation of all property in Montana. As part of this briefing, the Subcommittee was exposed to about two dozen different options for developing agricultural land valuations.

Working closely with the Advisory Council, the Subcommittee decided that the productive value of agricultural lands in Montana could best be determined by using a valuation method called the "capitalized net income" method. Once the method was settled upon, the Subcommittee set out to determine and recommend both the appropriate level of income and the appropriate capitalization rate.

Through extensive discussion with the Subcommittee's staff, the Department of Revenue's staff, the Advisory Council, various agricultural groups and interested persons, and agricultural economists from Montana State University, the Subcommittee decided to recommend to the Revenue Oversight Committee and the 49th Legislature a valuation option informally (and later formally) referred to as "Option I2C".

This option called for several things. First, the relative tax burden among the several types of agricultural land was to be maintained as much as possible. Second, tillable irrigated lands were to be valued in such a manner that the appraised value would not be less than such lands would be valued if they were not under irrigation. Third, the value of all agricultural lands would be based on "their ability to produce" as required by law, and the value assigned to each type of agricultural land would be keyed to the value of the median grade of nonirrigated (summer fallow) land.

When all of the conditions were met, agricultural land values developed under Option I2C resulted in surprise to many of the Subcommittee's and Revenue Oversight Committee's members. The values indicated by Option I2C would have decreased agricultural land values by approximately 59.5 percent.

The members of the Subcommittee recognized that Montana's local taxing jurisdictions, especially schools, could not afford to have agricultural land values reduced by 59 percent. With this recognition, the Subcommittee unanimously adopted the following recommendation to be presented to the Revenue Oversight Committee and to the 49th Legislature:

> That the values currently applied to agricultural lands be adopted as the values to be used for the appraisal cycle beginning January 1, 1986, except that the values applied to irrigated lands be

adjusted so that such lands' values are not below the value such land would have if it were not irrigated.

Armed with the startling calculations resulting from Option I2C, the chairman of the Subcommittee presented the Subcommittee's recommendation to the Revenue Oversight Committee on January 12, 1984. The members of the Revenue Oversight Committee reacted to the calculations with the same surprise as the Subcommittee's members.

Consideration by the Revenue Oversight Committee

The recommendation was discussed briefly at the January Revenue Oversight Committee meeting and resulted in a motion for a bill to be drafted embodying the Subcommittee's recommendation. Representative Nordtvedt, supporting the motion, requested that the record show that the Revenue Oversight Committee was authorizing the bill to be drafted, but not necessarily endorsing the provisions of the bill. He further commented that the relative tax burden between agricultural land taxpayers was only one of the issues addressed by the Subcommittee's recommendation. The other issue was one of relative tax burden between agricultural land taxpayers and all other taxpayers in the state. The Revenue Oversight Committee agreed that the latter issue was one of statewide concern and that it would have to be reviewed and examined fully before any further recommendation could be made.

The bills requested at the January meeting were presented to the Committee at the March 30-31 Revenue Oversight meeting. The first of the bills, LC 0002, was a straightforward revision to the law reflecting the Subcommittee's recommendation. (See Appendix for final draft of LC 0002.)

A second bill, LC 0003, included a proposal by the Department of Revenue that timberlands be separated from other agricultural lands into a totally different class. According to the Department, the purpose of this was to avoid litigation possible due to the continuance of existing agricultural land values. The Department felt that since the existing agricultural land values were, in effect, 1963 values, and since timberland was being revalued at current values, a potential litigable conflict could result.

Both of these bills were again on the Committee's agenda for the June 7, 1984 meeting. At that meeting another related issue was brought before the Committee as well. That issue was the new values to be applied to timberland. After a general discussion of the timber valuation issue, the Committee requested that another bill be drafted creating a new class of property solely for commercial timberlands.

This bill, LC 0062, was presented to the Committee at the August 24-25 meeting. The Department suggested that the bill be revised so as to allow the whole Legislature to define "commercial timberland" and to set the tax rate on such commercial timber. The Committee agreed that the Department's suggestion had merit and requested that the amendments be included in LC 0062. However, the Committee made no recommendation on the bill itself.

Recommendation

At the November 9, 1984, meeting, the Committee adopted a motion to recommend to the 49th Legislature the adoption of LC 0002. The recommendation was made with the reservation that the Revenue Oversight Committee should continue its examination of the state's entire property tax system, the possible result of which could be something other than or in addition to the recommendation made in LC 0002.

LIQUOR ISSUES

At practically every meeting of the Revenue Oversight Committee during the interim liquor issues were addressed, with most of the discussion centering around liquor licensing. Two aspects of licensing -- licensing criteria and license quotas -- commanded the most attention, with a bill draft resulting in each area.

License criteria

Montana is a "control" state as far as alcohol beverages are concerned. This term implies that the state, in some fashion, controls how, where, when, and by and to whom alcohol is sold. One of the manifestations of control by the state is the statutory quota system imposed on sellers of alcoholic beverages. While the philosophical grounds for the quota system escaped Committee discussions, the administration of the system commanded considerable attention.

Section 16-4-201, MCA, requires the Department of Revenue to determine, prior to issuing any original alcoholic beverage license, "that the issuance of such license is justified by public convenience and necessity." Although the Committee did not take exception to the requirement, it did have some questions as to what precisely constituted "public convenience and necessity."

The Committee's staff developed two research memoranda on the issue of "public convenience and necessity" and presented them to the Committee for discussion. After considerable discussion, the Committee requested that two bills be drafted, one requiring the Department of Revenue to adopt rules defining "public convenience and necessity" as applied to liquor licensing, and the other attempting to define "public convenience and necessity" statutorily. The two

bills -- LC 0019 and LC 0023 -- were prepared for, presented to, and discussed by the Committee at the August 24-25 meeting, but no action was taken on either bill. Further discussion of the two bills at the November 9 meeting also resulted in no recommendation. Consequently, the Committee tabled the two bills -- indefinitely.

Liquor license appeals

While neither of the two bills relating to "public convenience and necessity" were recommended by the Committee, the discussion surrounding the issue did result in other positive action by the Committee.

Representatives from both the liquor industry and from the Department of Revenue indicated that the appeals process associated with the issuance of a liquor license was cumbersome and could be streamlined without loss of due process to affected parties. The streamlining, they contended, could be effected through the elimination of an appeal to the State Tax Appeal Board.

Committee deliberation resulted in a request that a bill be drafted eliminating the State Tax Appeal Board from the liquor license appeal process, and specifying that the appeal process provided in the Montana Administrative Procedure Act be designated as the process for liquor license appeals. This request was developed into LC 0018 and was formally adopted at the August 24-25 meeting, to be recommended to the 49th Legislature. A copy of LC 0018 is included in the Appendix.

Transfer of all-beverages licenses and revisions for catering

Another area examined by the Committee was the situation apparently caused by Montana's quota system. The situation

referred to is one where some areas, principally Montana's fastest growing cities, are unable to obtain additional licenses for on-premises consumption of alcoholic beverages.

The Committee addressed this situation by requesting the staff to develop some options that would increase the flexibility in transferring alcoholic beverage licenses between quota areas. Of the several draft bills developed by the staff, the Committee gave significant consideration to two, LC 0060 and LC 0061.

The first of these bills, LC 0060, would have revised the transfer provisions in such a manner that:

1. The actual number of licenses in a quota area to which a license could be transferred could exceed the license quota by:

   (a) 40% (increased from 33%); or
   (b) 50% (increased from 43%) in the case of an incorporated city of more than 10,000 population; and

2. The actual number of licenses in a quota area from which a license could be transferred could exceed the license quota by 20% (decreased from 25%.)

The second bill, LC 0061, would have effected the same result, except that the increase would be gradual over the next several years and the percentages in 1(a), 1(b) and 2 would have, by 1991, changed to 47.5%, 57.5%, and 10% respectively.

The bills were presented to the Committee at the August 24-25 meeting but, at the request of the Montana Tavern Association, the Committee postponed discussion until the September 21-22 meeting.

At the September meeting, the Tavern Association proposed several additional amendments to LC 0060. The amendments eliminated the reduction in provision 2. (on the preceding page), and additionally made substantial revisions to the provisions allowing an "all-beverages" licensee to cater certain events. The Committee asked its staff to develop a revised version of LC 0060 to include the amendments proposed by the Tavern Association.

The new bill, LC 0112, was drafted and presented to the Committee at the November 9 meeting. After explanatory testimony from the Tavern Association, the Committee approved several additional amendments to the bill and adopted a motion to recommend the bill to the 49th Legislature. A copy of the recommended version of LC 0112 is included in the Appendix.

GLENDIVE AREA REQUEST

In August of 1984, the Burlington Northern Railroad let it be known that its roundhouse facility in Glendive was obsolete. According to BN, the railroad's options were to either rebuild the roundhouse in Glendive or construct a new facility in Mandan, North Dakota. The railroad suggested to the Glendive community that if some type of property tax reduction could be given to the railroad on a rebuilt facility in Glendive, the probability of the railroad remaining in the community would increase.

As a response to this suggestion, members of the Glendive Area Chamber of Commerce and Agriculture circulated petitions in their area requesting the Legislature to revise a provision of Montana law to allow for a property tax reduction for the rebuilding under consideration by Burlington Northern.

Bearing several hundred petition signatures, several members of the Glendive Chamber addressed the Revenue Oversight Committee on August 24 in Helena. The primary request of the group was for the statutory change to allow BN the property tax reduction.

After the Glendive Chamber's presentation and comments in support of the request by several Revenue Oversight Committee members, a motion to draft a bill effecting the requested revision was adopted by the Committee. And in addition to the draft legislation, the Committee also adopted a Resolution in support of the Glendive residents' efforts. The resolution is stated below.

> The Revenue Oversight Committee wholeheartedly supports the people of Glendive in encouraging and attempting to persuade the Burlington Northern to retain its diesel repair facility in Glendive and to reconstruct that facility in Glendive.

At the continuation of the Committee's meeting on August 25, the bill draft requested the previous day was presented to the Committee. (See Appendix for a copy of LC 0098.) The bill, LC 0098, would allow the appropriate local governing body to grant property tax relief (for 5 years) for the type of construction proposed by Burlington Northern, and for similar construction by others in the future. A motion to recommend LC 0098 to the 49th Legislature was adopted with only one dissenting vote.

ACTIVITIES AND REPORT OF THE COAL TAX OVERSIGHT COMMITTEE

The Coal Tax Oversight Committee (CTO), in its report to the Revenue Oversight Committee, presented a list of activities undertaken during the interim somewhat more extensive than previous Coal Tax Oversight Committees had pursued.

One of the activities was a joint meeting of the CTO Committee members with a group of legislators from North Dakota. The purpose of the meeting was to discuss coal development in the adjoining states. Although no recommendation resulted from the meeting, the CTO members felt the meeting was beneficial to the participants and to both states.

In addition to the North Dakota meeting, the CTO Committee engaged in a considerable amount other activity during the interim. A list of some of that activity is outlined below.

* Review of each program financed by coal severance tax funds.

* Reports from the sponsoring agencies associated with the coal tax-funded programs.

* Public hearings on the impact and rate of the coal severance tax.

* Report from the Board of Investments on the investment of coal tax revenue.

* Report from the Governor's Office on a proposed Natural Resource Legacy Program to be funded with Resource Indemnity Trust Tax revenue.

* Tour of the Westmoreland and Rosebud coal mines, and of the Colstrip power plants.

* Tour of the Montco proposed mine site near Ashland.

* Worked closely with Coal Board members on developing legislative changes to improve the Board's ability to assist impacted areas.

* Heard testimony on the need for funds for coal research.

The Coal Tax Oversight Committee adopted three bills for recommendation to the 49th Legislature. Those three draft bills -- LC 0043, LC 0082, and LC 0178 -- are included in the Final Report of the Coal Tax Oversight Committee for the 1983-1985 interim.

The first of these drafts, LC 0043, was titled, "An act authorizing the use for four years of coal severance tax proceeds for the development, operation, and maintenance of all state parks, recreational areas, monuments, or historical sites." Representative Glenn Roush, speaking as Chairman of the Coal Tax Oversight Committee, said that this bill draft not only had the support of the CTO Committee, but the support of the Department of Fish, Wildlife and Parks as well.

The second draft, LC 0082, was titled, "An act specifying allowable uses of county land planning funds." This draft legislation would clarify allowable uses of county land planning funds and would expand allowable uses of such funds to include comprehensive planning, economic development planning, and capital improvements planning as it relates generally to land planning. Chairman Roush reported that LC 0082 had the support of the Department of Commerce and the CTO Committee.

The final CTO Committee draft legislation, LC 0178, would create an "impact decline account", the funding of which would result from reversions of Coal Board grant money. The full title of the draft bill was, "An act establishing an impact of decline account to receive unexpended coal board appropriations; authorizing the coal board to designate local government units for impact and impact of decline grants and to award impact of decline grants and loans, providing an exception to the reversion law."

After reviewing the three CTO bill drafts, the Revenue Oversight Committee adopted motions to recommend LC 0043 and LC 0082 to the next Legislature. The Committee also decided that the Coal Tax Oversight Committee's recommendation on LC 0178 was sufficient recommendation, and consequently took no action on the draft.

The Coal Tax Oversight Committee made four additional recommendations, not in bill form, to the Revenue Oversight Committee and the 49th Legislature. Those recommendations were:

1. That appropriations to the Coal Board be effective for the entire 2-year period of a biennium.

2. That $2,100,000 a year be allocated from coal severance tax proceeds to reduce additional levies to support vocational-technical education centers.

3. That coal research be supported by coal severance tax proceeds with participation by coal companies and that such a program become self-sustaining.

4. That $12,000 be appropriated from the Local Impact and Education Trust Fund Coal Tax Account to the Legislative Council for the biennium ending June 30, 1987, for the operation of the Coal Tax Oversight Committee.

In its final action regarding the Coal Tax Oversight Committee's activities, the Revenue Oversight Committee voted unanimously to accept the final report of the Coal Tax Oversight Committee. That report, including the recommended legislation, is on file with the Legislative Council.

Summary

The activities of the Revenue Oversight Committee reported in this chapter are only a part of what the Committee did in addition to interim study work and Department of Revenue oversight. At any of the Committee's meetings it was not unusual for the members to discuss litigation issues, rules proposals, property reappraisal, Department/assessor relations, other liquor issues, natural resource taxation, or any number of other topics with which the Department of Revenue is associated.

In addition to the Committee's working relationship with the Department, the Committee also continued its practice of hearing and, when deemed appropriate, acting on citizen concerns. These concerns ranged widely and included: the location of state liquor stores; the taxation of wells and septic tanks; the taxation of natural resource royalty interests; timber taxation; certification of taxable values to county governments; tax agreements with other states; livestock taxation; and a variety of other topics.

A total account of issues addressed by the Committee is purposefully not included in this report because formal action was taken only in a few instances, such as the ones reported. It is, nevertheless, important to recognize that the Committee's concerns ranged beyond interim study work and statutorily required duties.

One final note: The Revenue Oversight Committee, in the spirit of cooperation with the Department of Revenue, agreed to request bill drafts by the Legislative Council of more than two dozen pieces of legislation recommended by the Department. Although these bills are not discussed or included in this final report, all have been read by the Committee members, received sponsorship by a Committee member, and will be identifiable in the 49th Legislature as having been drafted and introduced by request of the Revenue Oversight Committee and the Department of Revenue. A listing of those bills is included as the last page of the appendix.

APPENDIX

Bill drafts

_____ BILL NO. _____

INTRODUCED BY _____

BY REQUEST OF THE REVENUE OVERSIGHT COMMITTEE

A BILL FOR AN ACT ENTITLED: "AN ACT PROVIDING FOR ESTABLISHMENT OF AGRICULTURAL LAND VALUES FOR THE REVALUATION CYCLE BEGINNING JANUARY 1, 1986; AMENDING SECTION 15-7-210, MCA; AND PROVIDING A DELAYED EFFECTIVE DATE."

WHEREAS, House Bill 851 (Ch. 510, L. 1983) enacted by the 48th Legislature recognized the difficult economic circumstances of farmers and ranchers by placing a temporary moratorium on the effective date of any Department of Revenue rules revising agricultural land valuations; and

WHEREAS, House Bill 637 (Ch. 644, L. 1983) enacted by the 48th Legislature expanded upon the intent of the Legislature regarding the valuation of agricultural land; and

WHEREAS, House Joint Resolution 35 was adopted in the 1983 Legislative Session, calling for a study of agricultural land taxation; and

WHEREAS, the legislative interim Joint Subcommittee on Agricultural Land Taxation has studied taxes on agricultural land; and

WHEREAS, the Joint Subcommittee on Agricultural Land

Taxation found that the productive value of agricultural lands actually decreased since the last revaluation of agricultural land; and

WHEREAS, the Joint Subcommittee on Agricultural Land Taxation, with a policy of fairness and fiscal responsibility, recommended that assessed valuations currently in effect for agricultural land, except irrigated land, be continued for the revaluation cycle beginning January 1, 1986; and

WHEREAS, it is the intent of the Legislature to implement the recommendation of the Joint Subcommittee on Agricultural Land Taxation.

THEREFORE, it is the purpose of this bill to reflect that recommendation by amending section 15-7-201, MCA, and clarifying the legislative intent with respect to the valuation of agricultural lands.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 15-7-201, MCA, is amended to read:

"15-7-201. (Effective January 1, 1986) Legislative intent --value of agricultural property. (1) Since the market value of many agricultural properties is based upon speculative purchases which do not reflect the productive capability of agricultural land, it is the legislative intent that bona fide agricultural properties shall be classified and

assessed at a value that is exclusive of values attributed to urban influences or speculative purposes.

(2) Agricultural land shall be classified according to its use, which classifications shall include but not be limited to irrigated use, nonirrigated use, and grazing use.

~~(3)~~ Within each class of agricultural land, such land shall be assessed at a value that is fairly based on its ability to produce~~,---taking---into---consideration---the classification--system--in--existence--on--January--1,-1986, provided,-however,-the-department-may--consolidate--tillable irrigated--land--classes.--With--relation-to-irrigated-land, water-costs-shall-be-taken-into-consideration,-except-at--no time--may--the--resulting-value-of-irrigated-land-be-reduced below-the--value--such--land--would--have--if--it--were--not irrigated~~.

~~(4)~~(3) Capital costs such as improved water distribution, fertilizer, and land shaping that increase productivity shall not be used in determining assessed values.

(4) (a) Except as provided in subsections (4)(b) and (4)(c), the department shall continue to use the agricultural land valuation schedules in effect on January 12, 1984, for the revaluation cycle beginning January 1, 1985.

(b) Irrigated land values shall be revised taking water costs into consideration. However, at no time may the value

of irrigated land be below the value such land would have if it were not irrigated.

(c) The provisions of subsection (4)(a) do not apply to agricultural land used for growing timber."

NEW SECTION. Section 2. Effective date. This act is effective January 1, 1986.

-End-

_____ BILL NO. _____

INTRODUCED BY _____

BY REQUEST OF THE REVENUE OVERSIGHT COMMITTEE

A BILL FOR AN ACT ENTITLED: "AN ACT REMOVING THE STATE TAX APPEAL BOARD FROM THE APPEAL PROCESS RELATIVE TO BEER AND LIQUOR LICENSING; AND REQUIRING APPEALS TO BE CONDUCTED PURSUANT TO THE MONTANA ADMINISTRATIVE PROCEDURE ACT; AMENDING SECTION 16-4-411, MCA."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 16-4-411, MCA, is amended to read:

"16-4-411. Appeals concerning liquor and beer laws. (1) Any interested party shall have the right to appeal any decision of the department of revenue concerning the issuance, transfer, suspension, or revocation of beer or liquor licenses to the ~~state tax appeal board. The appeal shall be heard in conformity with the provisions of the Montana Administrative Procedure Act, and the decision of the state tax appeal board shall be final unless reversed or modified upon judicial review~~ district court in the county in which the issuance, transfer, suspension, or revocation occurred or, at the appellant's option, in the district court of the first judicial district.

(2) The appeal must be in conformity with the provisions

of Title 2, chapter 4, part 7."

-End-

_____ BILL NO. _____

INTRODUCED BY _____

BY REQUEST OF THE REVENUE OVERSIGHT COMMITTEE

A BILL FOR AN ACT ENTITLED: "AN ACT PROVIDING INCREASED FLEXIBILITY IN TRANSFERRING ALL-BEVERAGES LICENSES BY REVISING TRANSFER QUOTA LIMITATIONS; ELIMINATING THE PROHIBITION OF TRANSFERRING A PREVIOUSLY TRANSFERRED LICENSE; REDUCING THE ANNUAL FEE FOR A CATERING LICENSE; REVISING THE PROCEDURE FOR A CATERING ENDORSEMENT; AND REDUCING THE FEE FOR CATERING AN EVENT; AMENDING SECTION 16-4-204, MCA."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 16-4-204, MCA, is amended to read:

"16-4-204. Transfer -- catering endorsement. (1) (a) Except as provided in subsection (1)(b), a license may be transferred to a new ownership and to a location outside the quota area for which it was originally issued only when the following criteria are met:

(i) the total number of all-beverages licenses in the original quota area exceeded the quota for that area by at least 25% in the most recent census prescribed in 16-4-502;

(ii) the total number of all-beverages licenses in the quota area to which the license would be transferred did not

Montana Legislative Council

exceed that area's quota in the most recent census prescribed in 16-4-502:

(A) by more than ~~33%~~ 40%; or

(B) in an incorporated city of more than 10,000 inhabitants and within a distance of 5 miles from its corporate limits by more than ~~43%~~ 50%; and

(iii) the department finds, after a public hearing, that the public convenience and necessity would be served by such a transfer.

(b) A license within an incorporated quota area may be transferred to a new ownership and to a new unincorporated location within the same county on application to and with consent of the department when the quota of the all-beverages licenses in the original quota area exceeds the quota for that area by at least 25% in the most recent census and will not fall below that level because of the transfer.

(c) For 5 years after the transfer of a license between quota areas under subsection (1)(a), the license may not be mortgaged or pledged as security and may not be transferred to another person except for a transfer by inheritance upon the death of the licensee.

~~(d)--Once-a-license-is-transferred-to-a-new-quota--area under--subsection--(1)(a),--it--may--not--be--transferred-to another-quota-area-or-back-to-the-original-quota-area.~~

(2) (a) Any all-beverages licensee is, upon the approval and in the discretion of the liquor division, entitled to a catering endorsement to his all-beverages license to allow the catering and sale of alcoholic beverages to persons attending a one or more special event events upon premises not otherwise licensed for the sale of alcoholic beverages, such beverages to be consumed on the premises where the such an event is held.

(b) ~~A written application~~ The annual fee for a catering endorsement ~~and an annual fee of $250 must be submitted to the department for its approval~~ is $125.

(c) ~~A written application for each event for which the licensee intends to provide catering services, the written approval of the catering application by the sponsor of the special event, and a fee of $35 must be filed with the department at least 3 days prior to the event and shall describe~~ There must be filed with the department:

(i) a statement for each event for which the licensee intends to provide catering services, describing the location of the premises where the event is to be held, the nature of the event, and the period during which the event is to be held~~.~~; and

(ii) a written statement of approval of the premises by the local law enforcement agency that has jurisdiction over the premises where the event is to be held. ~~An all-beverages~~

~~licensee who holds an endorsement granted under this subsection (2) may not receive approval to cater an event of which he is the sponsor. The catered event must be within 100 miles of the licensee's regular place of business. If obtained, the licensee shall display in a prominent place on those premises, the written approval from the department for each event which is catered pursuant to this subsection.~~ The fee for each event is $5 a day.

(d) ~~The licensee shall file with each application for an event to be catered a written statement of approval of the premises where the event is to be held issued by the department of health and environmental sciences and the local law enforcement agency that has jurisdiction over the premises where the event is to be held.~~ An all-beverages licensee who holds a catering endorsement granted under this subsection (2) may not cater one event or events in one location for more than 30 days within each calendar year.

(e) The sale of alcoholic beverages pursuant to a catering endorsement is subject to the provisions of 16-6-103.

(f) The sale of alcoholic beverages pursuant to a catering endorsement is subject to the provisions of 16-3-306, unless entities named in 16-3-306 give their written approval."

NEW SECTION. Section 2. Extension of authority. Any

existing authority of the department of revenue to make rules on the subject of the provisions of this act is extended to the provisions of this act.

-End-

_____ BILL NO. _____

INTRODUCED BY _____

BY REQUEST OF THE REVENUE OVERSIGHT COMMITTEE

A BILL FOR AN ACT ENTITLED: "AN ACT PERMITTING LOCAL GOVERNING BODIES TO GRANT TAX BENEFITS FOR THE RECONSTRUCTION OR EXPANSION OF EXISTING BUILDINGS OR STRUCTURES; AMENDING SECTION 15-24-1501, MCA."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 15-24-1501, MCA, is amended to read:

"15-24-1501. Remodeling, reconstruction, or expansion of buildings or structures -- assessment provisions. (1) Remodeling, reconstruction, or expansion of existing buildings or structures may receive tax benefits during the construction period and for the following 5 years in accordance with the following schedule. The percentages shall be applied to any increase in taxable value caused by the remodeling, reconstruction, or expansion:

Construction period	0%
First year following construction	20%
Second year following construction	40%
Third year following construction	60%
Fourth year following construction	80%
Fifth year following construction	100%

Following years 100%

(2) In order to receive the tax benefits described in subsection (1), the governing body of a county or incorporated city or town must have approved by resolution the use of the schedule provided for in subsection (1) for their respective jurisdiction."

NEW SECTION. Section 2. Extension of authority. Any existing authority of the department of revenue to make rules on the subject of the provisions of this act is extended to the provisions of this act.

-End-

BILL	SPONSOR
LC 18	MAZUREK
LC 58	RAMIREZ (MOTION APPROVED AS AMENDED, RAMIREZ)
LC 98	SWITZER
LC 112	CRIPPEN
LC 149	TOWE
LC 150	TOWE
LC 151	TOWE
LC 152	TOWE
LC 153	BROWN
LC 154	WILLIAMS
LC 155	BROWN
LC 156	MAZUREK
LC 158	CRIPPEN
LC 159	NORMAN
LC 160	NORMAN
LC 161	TOWE
LC 162	KEENAN
LC 163	MAZUREK
LC 164	WILLIAMS
LC 165	TOWE
LC 166	KEENAN
LC 167	WILLIAMS
LC 168	BROWN
LC 169	TOWE
LC 171	WILLIAMS
LC 172	KEENAN
LC 176	MAZUREK
LC 280	WILLIAMS
LC 402	NORMAN
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